

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

IN RE WASHINGTON MUTUAL, INC.  
SECURITIES LITIGATION

This Document Relates to: ALL ACTIONS

No. 2:08-md-1919 MJP  
Lead Case No. C08-387 MJP

**CLASS ACTION COMPLAINT**

JURY DEMAND

**CONSOLIDATED CLASS ACTION COMPLAINT**

Lead Plaintiff's  
Consolidated Securities Complaint  
No. 2:08-MD-1919 MJP

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1 The allegations set forth in this Consolidated Class Action Complaint (the “Complaint”)  
2 are based on the investigation undertaken by Lead Counsel on behalf of Lead Plaintiff, Ontario  
3 Teachers’ Pension Plan Board. This investigation has included, among other things: review and  
4 analysis of internal, non-public Washington Mutual, Inc. (“Washington Mutual,” “WaMu,” or  
5 the “Company”) documents obtained through the investigation; detailed interviews with  
6 numerous former employees of WaMu and other persons with knowledge of the events alleged  
7 herein; analyses by experts in the fields of banking regulation, mortgage finance, accounting, and  
8 loss causation; analyses of hundreds of millions of loan records reported by WaMu pursuant to  
9 the Home Mortgage Disclosure Act (“HMDA”); review of WaMu and other relevant company  
10 filings with the Securities and Exchange Commission (“SEC”); review of guidance issued by the  
11 federal banking regulatory authorities; examination of WaMu’s communications with the Office  
12 of Thrift Supervision (“OTS”); examination of generally accepted accounting principles in the  
13 United States (“GAAP”); review of the WaMu and other relevant websites; and examination of  
14 WaMu and other relevant company press releases, news articles and analyst reports. The bulk of  
15 this information – such as witness statements from former WaMu insiders and non-public WaMu  
16 documents and analysis of key WaMu data – was not previously available, or disclosed, to the  
17 investing public. The results of the investigation on behalf of Lead Plaintiff are discussed  
18 throughout this Complaint.

## 21 **I. OVERVIEW OF THE ACTION**

22 1. Washington Mutual has long held itself out as a conservative savings and loan  
23 company, subject to rigorous controls and standards, run by a group of officers who manage the  
24 Company in a manner intended to make it attractive to institutional investors and others.  
25 Although the Company is involved in other banking activities, WaMu’s home loan business has  
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1 long been the primary driver of its business success. For instance, for the years 2006 and 2007,  
2 just under 70% of WaMu's net interest income was generated by residential real estate loans and  
3 related products and over 60% of WaMu's overall average assets were generated by residential  
4 real estate loans and related products. As those figures make clear, WaMu's success in recent  
5 years had come to depend largely on its home loan business. To help ensure the legitimacy and  
6 longevity of that business, WaMu and its senior officers touted a number of safeguards and  
7 protections they were actively managing within the Company for that very purpose, including:  
8

- 9 • An Authoritative Risk Management Approach and Group. The Company  
10 supposedly used an effective approach to Risk Management that prevented it from  
11 taking unwarranted risks (and thereby imposing such risks on investors) and which  
12 involved giving WaMu's Risk Management Group authority to keep in check those  
13 within the Company who may be incentivized to take on more risk than would be in  
14 the Company's long-term interest (including certain sales personnel).  
15
- 16 • Fair, Credible Appraisals. The use of reliable home appraisals is critical in the  
17 home loan business, because without credible appraisals the extent to which the home  
18 loans at issue are adequately collateralized is unknown. Furthermore, accurate  
19 appraisals are needed to assess the likelihood of default by the borrower. As WaMu's  
20 disclosures explain, home loans with loan-to-value ("LTV") ratios of greater than 80  
21 percent "expose the Company [and thus investors] to greater risk" than loans with  
22 lower LTV ratios. Without credible appraisals, the LTV ratios for home loans issued  
23 by the Company would be subject to manipulation, and borrowers could be issued  
24 larger mortgages than they could realistically repay. The Company supposedly issued  
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1 loans that were the product of only fair, reliable, and independent appraisals, and  
2 therefore investors could rely on WaMu's purportedly low LTV ratios.

3 • High Underwriting Standards. These are the quality control standards used to  
4 determine whether to make loans to borrowers. WaMu has claimed it maintains the  
5 highest underwriting standards intended to minimize the credit risk involved in  
6 lending sums to borrowers.

7  
8 • Appropriate Allowances for Loan Losses. This is to represent a calculation of  
9 incurred credit losses inherent in the Company's loan portfolios as of a given date.  
10 WaMu proclaimed that it followed all appropriate accounting standards in this area,  
11 and that it also had successfully developed statistical forecasting models to help it  
12 appropriately calculate the "Allowance" every quarter.

13  
14 These facts, as disclosed by WaMu and its officers, helped assure investors that the Company's  
15 results in the home loan business were credible and reliable because of WaMu's conservative  
16 approach to the business.

17 2. Only recently has the truth regarding WaMu's business begun to emerge, causing  
18 enormous losses for investors in WaMu securities. Lead Plaintiff's investigation has uncovered  
19 massive volumes of information never before available to the investing public, all of which sheds  
20 light on the true nature and condition of WaMu's business. This information is based on an  
21 unprecedented number of detailed statements of former insiders at WaMu and related companies,  
22 who themselves observed the true conduct and condition of the Company. The first-hand  
23 observations of just under ninety (90) witnesses discussed below are further supported by  
24 internal, non-public documents obtained by Lead Counsel through its investigation, as well as  
25 detailed expert analyses in several areas. In short, the information uncovered by Lead Plaintiff's  
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1 investigation shows that WaMu is and has been a vastly different Company than portrayed by  
2 WaMu and its Officers in recent years. For instance, contrary to WaMu's disclosures:

- 3 • Lack of Risk Management. Internal WaMu materials and many detailed  
4 witness statements confirm that in recent years Risk Management has been relegated  
5 to a toothless "supportive role" rather than the authoritative policing role it  
6 supposedly maintained. This has allowed management at the highest levels to  
7 increase the level of risk assumed by the Company without informing investors of  
8 this critical fact.
- 9 • Systematically Inflated Appraisals. Numerous percipient witnesses as well as  
10 detailed expert analysis of WaMu data confirm that WaMu has been systemically  
11 corrupting and influencing the appraisal process such that it has been inflating  
12 appraisals issued both in-house and those obtained from supposedly independent  
13 third-parties. This includes, but goes far beyond, information disclosed by the New  
14 York Attorney General concerning WaMu's corrupt appraisal practices.
- 15 • Dangerously Permissive Underwriting Standards. Detailed statements from  
16 many former WaMu employees and others directly involved, along with internal  
17 WaMu documents and expert analysis of WaMu data, show that the Company has  
18 been using dangerously lax underwriting standards. WaMu's abandonment of  
19 acceptable underwriting standards extended to both "prime" home mortgages as well  
20 as "subprime" loans. This has been to the detriment of both investors and borrowers.
- 21 • Woefully Inadequate Allowances for Loan Losses. Internal WaMu materials,  
22 numerous percipient witnesses, and detailed expert analysis all show that WaMu's  
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1 Allowance was “under-provisioned” from the third quarter of 2005 through the fourth  
2 quarter of 2007 by amounts often in the hundreds of millions of dollars.

3 3. By October 17, 2007 the Company could no longer continue to completely hide  
4 the truth about – and consequences resulting from – its secret, unlawful and high-risk activities.  
5 WaMu also could no longer fully conceal that its portfolio of supposedly high-quality home  
6 loans was tainted with substantially impaired assets and, therefore, was suffering from losses not  
7 reasonably expected by the investing public in light of WaMu’s prior disclosures. From October  
8 17, 2007 through July 23, 2008, the Company shocked the market in a series of disclosures each  
9 partially revealing the true condition of WaMu’s home loan business and loan portfolios. During  
10 this time, WaMu’s common stock plummeted as the truth emerged, from a share price of \$33.07  
11 on October 17, 2007 to \$4.65 per share on July 23, 2008 – an 86% decline in the course of only  
12 months.  
13

14 4. Consistent with the Private Securities Litigation Reform Act, these facts are  
15 discussed in detail in this Complaint. All of the witness statements, internal documents, and  
16 expert analyses discussed in detail in this Complaint have, of course, been obtained without the  
17 benefit of discovery. Despite the substantiated and detailed nature of the allegations presented  
18 herein, when one high-level executive who recently departed WaMu was informed by Lead  
19 Counsel of the nature and substance of the allegations to be included in this Complaint, he  
20 responded: “that’s only the tip of the iceberg.” In any event, the facts discussed below show that  
21 WaMu’s disclosures to the investing public in recent years are entirely contrary to the true  
22 condition of the Company.  
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## II. THE CLAIMS ASSERTED IN THE COMPLAINT

5. Lead Plaintiff asserts two sets of claims on behalf of the Class (as defined in ¶51). The first set of claims arises from allegations of securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) against those defendants, including WaMu and certain former and current officers, who made materially false and misleading statements that caused the prices of WaMu securities to be artificially inflated over the course of the Class Period, October 19, 2005 through July 23, 2008. Lead Plaintiff also asserts control-person claims under Section 20(a) of the Exchange Act. A chart identifying the parties named under each Exchange Act claim is attached as Appendix 2.

6. The second set of claims arises under Sections 11 and 12 of the Securities Act of 1933 (the “Securities Act”) against those defendants who are alleged to be statutorily liable under a theory of strict liability and/or negligence for materially untrue statements and misleading omissions made in connection with the Registration Statement and Offering Documents (defined below at ¶817) for a series of securities offerings WaMu conducted between August 2006 and December 2007 (the “Offerings”). Through those Offerings, WaMu raised a total of \$4.8 billion. Lead Plaintiff also asserts control-person claims under Section 15 of the Securities Act. The claims arising under the Securities Act are addressed in Section XIV of the Complaint. A chart identifying the parties named under each Securities Act claim is attached as Appendix 3.

## III. JURISDICTION AND VENUE

7. The claims asserted herein arise under Sections 11, 12(a)(2) and 15 of the Securities Act (15 U.S.C. §§ 77k, 77l and 77o); and under Sections 10(b) and 20(a) of the Exchange Act (15 U.S.C. §§ 78j(b), 78t(a) and 78t-1) and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder by the SEC.

1           8.       This Court has jurisdiction pursuant to Section 22 of the Securities Act (15 U.S.C.  
2 § 77v); Section 27 of the Exchange Act (15 U.S.C. § 78aa); and 28 U.S.C. §§ 1331 and 1337.

3           9.       Venue is proper in this District pursuant to Section 22 of the Securities Act (15  
4 U.S.C. § 77v); Section 27 of the Exchange Act (15 U.S.C. § 78aa); and 28 U.S.C. § 1391(b) and  
5 (c). Many of the acts and transactions constituting the violations of the law alleged herein  
6 occurred in this District. In addition, WaMu maintains its corporate headquarters and principal  
7 executive offices in this District and did so throughout the Class Period.

8           10.      Venue is also proper in this District pursuant to the Transfer Order by the United  
9 States Judicial Panel on Multidistrict Litigation (the “MDL Panel”), dated February 21, 2008,  
10 whereby the MDL Panel transferred all securities, derivative, and ERISA actions related to  
11 “factual questions arising from alleged misrepresentations or omissions concerning WaMu’s  
12 financial condition” to this District for pre-trial purposes.

13           11.      In connection with the acts and conduct alleged in this Complaint, Defendants,  
14 directly and indirectly, used the means and instrumentalities of interstate commerce, including,  
15 but not limited to, the United States mails, interstate telephone communications, and the facilities  
16 of the national securities exchanges and markets.

#### 17           **IV.    THE PARTIES**

##### 18                   **A.    Plaintiffs**

##### 19                           **Lead Plaintiff**

20           12.      Lead Plaintiff Ontario Teachers’ Pension Plan Board (“Ontario Teachers”) is the  
21 largest single-profession pension plan in Canada. Ontario Teachers invests the pension plan’s  
22 assets and administers the pensions of approximately 278,000 active and retired teachers in  
23 Ontario. As of December 31, 2007, Ontario Teachers held more than C\$108 billion  
24 (approximately US\$105 billion) in net assets. Ontario Teachers purchased 5,484,937 shares of  
25

Washington Mutual common stock on the New York Stock Exchange (“NYSE”) during the Class Period and suffered damages as the result of the violations of the federal securities laws alleged herein.

13. By Order dated May 7, 2008, the Honorable Marsha J. Pechman, United States District Court Judge for the Western District of Seattle, appointed Ontario Teachers as Lead Plaintiff for this litigation.

#### **Additional Named Plaintiff**

14. Plaintiff Brockton Contributory Retirement System (“Brockton”) is one of 106 contributory retirement systems for public employees within the Commonwealth of Massachusetts. Brockton purchased WaMu’s 7.250% subordinated notes due November 1, 2017 ( the “7.250% Notes”) on the Offering that was announced on October 25, 2007 and conducted on behalf of Washington Mutual on or about October 29, 2007. Brockton suffered damages as a result of the federal securities law violations alleged herein. Lead Plaintiff and Plaintiff Brockton are collectively referred to as “Plaintiffs.”

#### **B. The Exchange Act Defendants<sup>1</sup>**

##### **Washington Mutual, Inc.**

15. Defendant Washington Mutual is a Washington corporation, with its executive and business segment headquarters located at 1301 Second Avenue, Seattle, Washington 98101. At all relevant times, WaMu was a savings and loan holding company with two banking subsidiaries and numerous nonbank subsidiaries.<sup>2</sup> As a savings and loan holding company, WaMu (including

<sup>1</sup> Defendants named in the Securities Act claims are set forth in Section XIV below.

<sup>2</sup> WaMu’s subsidiaries include, among others, Washington Mutual Bank, formerly known as Washington Mutual Bank FA, and Washington Mutual Preferred Funding LLC. Consistent with the Company’s Forms 10-K for the years 2005 through 2007, the definition of Washington



its banking subsidiaries) is subject to regulation by the Office of Thrift Supervision (“OTS”). WaMu was founded in 1889 as the Washington National Building Loan and Investment Association, and it is the largest savings and loan association in the country.

16. WaMu has four operating segments: the Home Loans Group, the Retail Banking Group, the Card Services Group and the Commercial Group. Of particular relevance to the allegations of the Complaint are the Company’s Home Loans and Retail Banking Groups. As set forth in the Company’s Form 10-K for the year-ended December 31, 2006 (the “2006 Form 10-K”), the primary activities of the Home Loans Group include: (1) the origination and servicing of home loans; (2) the fulfillment and servicing of home equity loans and lines of credit; (3) managing the Company’s capital market operations, which includes the buying and selling of all types of real estate secured loans in the secondary market; and (4) holding the Company’s held for investment portfolio of home loans, home equity loans and home equity lines of credit made through the Company’s subprime mortgage channel.

17. Within WaMu’s Home Loans Group, WaMu’s subprime mortgage channel originates, purchases, and holds for investment home loans and home equity loans issued to

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Mutual includes its subsidiaries. For example, in its Form 10-K for the year ended December 31, 2006, WaMu specifically defined itself to include its subsidiaries, stating:

With a history dating back to 1889, Washington Mutual, Inc. (together with its subsidiaries, “Washington Mutual,” the “Company”, “we”, “us”, or “our”) is a consumer and small business banking company with operations in major U.S. markets. Based on its consolidated assets at December 31, 2006 the Company was the seventh largest among all U.S.-based bank and thrift holding companies.

\* \* \*

When we refer to “the Company,” “we,” “our” and “us” in this Annual Report on Form 10-K, we mean Washington Mutual, Inc. and subsidiaries. When we refer to Parent, we mean Washington Mutual, Inc.

WaMu’s Forms 10-K for the years ended December 31, 2005 and December 31, 2007 included substantially similar statements.

1 subprime borrowers. In particular, WaMu originates subprime loans through its subprime  
2 division, known as “Long Beach Mortgage” (“LBM”) until January 1, 2006 and known  
3 thereafter as the Company’s “specialty mortgage lending” channel, or purchases such loans from  
4 lenders who are generally recognized as subprime lenders. WaMu’s subprime channel was  
5 originally part of the Company’s Commercial Group, but was moved to the Home Loans Group  
6 in 2006. As of December 31, 2006, WaMu’s subprime mortgage channel loans held for  
7 investment totaled \$20.77 billion, of which \$4.40 billion were originated by LBM and \$16.37  
8 billion were purchased from outside subprime lenders.

10 18. The primary activities of WaMu’s Retail Banking Group include: (1) offering a  
11 comprehensive line of deposit and other retail banking products and services to consumer and  
12 small businesses; (2) holding both the Company’s portfolio of home loans held for investment  
13 and the substantial majority of its portfolio of home equity loans and lines of credit (but not the  
14 Company’s portfolio of mortgage loans originated or purchased through the subprime mortgage  
15 channel); (3) originating home equity loans and lines of credit; and (4) providing investment  
16 advisory and brokerage services, sales of annuities and other financial services.

18 19. In addition to its operating segments noted above, WaMu maintained a “Corporate  
19 Support/Treasury and Other” business segment during the Class Period which, among other  
20 things, managed the Company’s: (1) interest rate risk, liquidity position, and capital; (2)  
21 enterprise-wide identification, measurement, monitoring, control, and reporting of credit, market,  
22 and operational risk; (3) community-lending and investment activities; (4) impact of changes in  
23 the unallocated allowance for loan losses; (5) net impact of fund transfer pricing for loan and  
24 deposit balances; and (6) transfers of loans from the Retail Banking Group to the Home Loans  
25 Group.  
26

20. At all relevant times, WaMu was listed on the NYSE, where its stock was publicly traded under the symbol “WM.” As of January 31, 2007, there were over 880 million shares of WaMu common stock outstanding.

#### **The Officer Defendants**

21. Defendant Kerry K. Killinger (“Killinger”) has served as the Company’s Chief Executive Officer since 1990 and as a member of the Company’s Board of Directors (the “Board”) since 1988. Killinger also served as the Company’s President from 1988 through 2004, and as Chairman of the Board from 1991 until June 30, 2008. Killinger has also served as a member of the Company’s Executive Committee since its creation in 1990, and as Chair of the Corporate Development Committee since its creation in 1997. Killinger joined WaMu in 1982 and, from 1982 until his appointment as President in 1988, he held numerous positions, including executive vice president; senior vice president for financial management, research, investor relations and corporate marketing; and member of a three-person Office of the President. From 2005 through 2007, Killinger received over \$33 million in total compensation, including at least \$7 million in bonus compensation.

22. Defendant Thomas W. Casey (“Casey”) has served as Executive Vice President and Chief Financial Officer of WaMu since October 2002. Casey has also served as a member of the Executive Committee since 2002, overseeing the Company’s corporate finance, strategic planning and investor relations functions. From 2005 through 2007, Casey received over \$11 million in total compensation, including at least \$3 million in bonus compensation.

23. Defendant Stephen J. Rotella (“Rotella”) has served as WaMu’s President and Chief Operating Officer since January of 2005. In this position, Rotella is responsible for overseeing the Company’s retail banking, home loans, credit card, and commercial lines of

1 business, as well as the Company's technology group and day-to-day administration. Rotella has  
2 also served on the Executive Committee since joining the Company in 2005 and, from March  
3 2005 to August 2005, he served as the Acting Head of the Home Loans Group. Rotella has  
4 extensive financial, business, and industry experience. From 2005 through 2007, Rotella  
5 received over \$29.7 million in total compensation, including at least \$6.9 million in bonus  
6 compensation.  
7

8 24. Defendant Ronald J. Cathcart ("Cathcart") served as Executive Vice President and  
9 Chief Enterprise Risk Officer of WaMu from December 2005 until April 2008. In this position,  
10 Cathcart was responsible for overseeing the credit, market, operational, and compliance risk  
11 functions for the Company. Cathcart also served as a member of the Executive Committee from  
12 December 2005 to April 2008. During 2007, Cathcart received at least \$1.9 million in  
13 compensation.  
14

15 25. Defendant David C. Schneider ("Schneider") has served as Executive Vice  
16 President and President of Home Loans since August 2005. In this position, Schneider is  
17 responsible for overseeing all aspects of the Company's home lending operations, with  
18 responsibility for the group's overall business strategy and its production and servicing channels.  
19 Schneider has also served as a member of the Executive Committee since August 2005.  
20 Schneider has extensive financial, accounting, business, and industry experience. During 2005,  
21 Schneider received \$2.3 million in total compensation, including at least \$492,000 in bonus  
22 compensation.  
23

24 26. Defendants Killinger, Casey, Cathcart, Rotella, and Schneider are referred to  
25 herein collectively as the "Officer Defendants."  
26  
27

**The Controller Defendants**

27. Defendant John F. Woods (“Woods”) served as Senior Vice President and Controller for WaMu from December 2005 until March 2007. In this position, Woods managed WaMu’s Corporate Accounting and Financial Reporting divisions and served as the Company’s principal accounting officer. In March 2007, Woods became the Chief Financial Officer of WaMu’s Home Loan Group.

28. Defendant Melissa J. Ballenger (“Ballenger”) joined WaMu in August 2006 as Senior Vice President and Assistant Controller. Ballenger became Controller in March 2007, serving as the Company’s principal accounting officer.

29. Defendants Woods and Ballenger are referred to herein collectively as the “Controller Defendants.”

**The Audit Committee and Finance Committee Defendants**

30. Defendant Anne V. Farrell (“Farrell”) served as a director of the Company from 1994 through April 2008. During her tenure as a director, Farrell served on several committees including the Finance Committee (2004-2008); the Governance Committee (1997-2004 and 2006-2008); and the Corporate Relations Committee (1997-2008, Chair 1997-2006).

31. Defendant Stephen E. Frank (“Frank”) has served as a director of the Company since 1997, and since July 1, 2008, as Chairman of the Board. During his tenure as a director, Frank has served on several committees, including the Audit Committee (1997-present, Vice Chair 2001-2004, and Chair 2004-present); the Finance Committee (2001-present); the Human Resources Committee (2002-present); and the Corporate Development Committee (2002-present).

32. Defendant Thomas C. Leppert (“Leppert”) has served as a director of the Company since September 2005. During his tenure as a director, Leppert has served on several committees including the Audit Committee (2005-present); the Governance Committee (2005-present, Chair 2008-present); and the Corporate Relations Committee (2005-present, Chair 2007-2008).

33. Defendant Charles M. Lillis (“Lillis”) has served as a director of the Company since June 2005. During his tenure as a director, Lillis has served on several committees including the Finance Committee (2005-present); the Human Resources Committee (2005-present); and the Corporate Development Committee (2005-present).

34. Defendant Phillip D. Matthews (“Matthews”) has served as a director of the Company since 1998. During his tenure as a director, Matthews has served on several committees, including the Audit Committee (2001-2007); the Finance Committee (2001-2004); the Governance Committee (1998-present); the Human Resources Committee (2004-present); and the Corporate Development Committee (2006-present).

35. Defendant Regina Montoya (“Montoya”) has served as a director of the Company since April 2006. During her tenure as a director, Montoya has served on the Finance Committee (2006-present) and the Corporate Relations Committee (2006-present, Chair 2008-present).

36. Defendant Michael K. Murphy (“Murphy”) has served as a director of the Company since 1985. During his tenure as a director, Murphy has served on several committees, including, among others, the Audit Committee (2004-present); the Finance Committee (2001-present, Chair 2001-2004); and the Corporate Relations Committee (2000-present).

37. Defendant Margaret Osmer-McQuade (“Osmer-McQuade”) has served as a director of the Company since 2002. During her tenure as a director, Osmer-McQuade has

served on several committees, including, among others, the Finance Committee (2002-present); the Governance Committee (2002-present); and the Human Resources Committee (2005-present).

38. Defendant Mary E. Pugh (“Pugh”) served as a director of WaMu from 1999 until April 2008. During her tenure as a director, Pugh served on several committees, including the Finance Committee (2001-2008, Chair 2004-2008) and the Corporate Relations Committee (2000-2008).

39. Defendant William G. Reed, Jr. (“Reed”) has served as a director of the Company since 1970. During his tenure as a director, Reed has served on several committees, including the Audit Committee (from at least 1996-present); the Finance Committee (2004-present); and the Governance Committee (from at least 1996-present, Chair from at least 1996-2008). Reed has also served as a director for WaMu subsidiary, Washington Mutual Bank.

40. Defendant Orin C. Smith (“Smith”) has served as a director of the Company since July 2005. During his tenure as a director, Smith has served on the Audit Committee (2005-present), the Governance Committee (2005-present), and the Finance Committee (Chair 2008-present).

### **C. Relevant Non-Parties**

#### **First American Corporation**

41. First American Corporation (“First American”) is organized under the laws of California and has its executive offices at 1 First American Way, Santa Ana, California 92707.

42. First American operates in all fifty states, except Iowa. First American provides appraisal services to mortgage lenders, real estate agents, investors, and other businesses requiring valuations of real property. According to First American’s website, it provides “quality

1 settlement services that rank number one in their industries, including appraisal and property  
2 valuation.”

3 43. First American’s consolidated revenue in 2006 and 2007 was \$8.5 and \$8.2  
4 billion, respectively. These amounts reflected revenue for First American and all of its controlled  
5 subsidiaries. Significantly, according to First American’s 2008 Form 10-K, operating revenues  
6 for its Property Information segment increased 23.5% from 2006 to 2007, in large part from  
7 growth in the appraisal division.  
8

9 44. At all times relevant to this Complaint, First American eAppraiseIT  
10 (“eAppraiseIT”), a Delaware Corporation, was a wholly-owned subsidiary of First American.  
11 eAppraiseIT is a provider of real estate valuation products and services. On its webpage,  
12 eAppraiseIT touts its nationwide presence and “extensive experience and knowledge in both the  
13 valuation and lending arenas.”  
14

15 45. According to its website, eAppraiseIT offers both traditional valuation services,  
16 including desk and field reviews, as well as on-line and electronic valuation services. First  
17 American, which discusses eAppraiseIT as part of its public reporting in 2006, highlighted its  
18 purportedly unbiased, third party evaluations through eAppraiseIT, which it claimed aided real  
19 estate professionals, home owners, and lenders to accurately determine value and mitigate risk.  
20

21 46. WaMu first contracted with eAppraiseIT in April 2006 to conduct appraisals that  
22 previously had been handled by a large, in-house WaMu staff. On November 1, 2007, the State  
23 of New York filed suit against the First American and eAppraiseIT (the “NYAG Complaint”),  
24 alleging that WaMu had handpicked appraisers and otherwise manipulated the appraisal process  
25 through eAppraiseIT to increase values in appraisal reports related to WaMu loans. The NYAG  
26 Complaint further alleges that while publicly touting its independence, eAppraiseIT was directed  
27



by First American to continue the fraudulent conduct and allow WaMu to artificially boost appraisal values at WaMu's behest.

47. According to the NYAG Complaint, eAppraiseIT conducted more than 260,000 appraisals for WaMu, receiving over \$50 million from WaMu. WaMu suspended its relationship with eAppraiseIT late in the Class Period, on or about November 2007.

#### **Lenders Services Inc.**

48. Lenders Services Inc. ("LSI") provides appraisal, title, and closing services to residential mortgage originators and is a competitor of eAppraiseIT. Since 2003, LSI has been a Fidelity National Financial subsidiary.

49. LSI is headquartered in Coraopolis, Pennsylvania, and, as of June 2008, had more than 600 employees. LSI has seven main business services, including Property Valuation, which consists of traditional and automated appraisals.

50. As explained in detail herein, starting in mid-2006, like eAppraiseIT, LSI provided significant appraisal services to WaMu pursuant to an agreement between WaMu and LSI.

#### **V. CLASS ACTION ALLEGATIONS**

51. Lead Plaintiff brings this action as a class action pursuant to Rule 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure on behalf of all persons or entities who purchased or otherwise acquired securities issued by WaMu and its subsidiaries and that traded on an efficient market,<sup>3</sup> during the period from October 19, 2005 through July 23, 2008 (as defined above the "Class Period"), and were damaged thereby (the "Class"). Excluded from the

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<sup>3</sup> This excludes, for instance: (i) purchasers of certificates of deposit offered by WaMu or its subsidiaries; and (ii) purchasers of pass-through securities that are not general obligations of WaMu.

1 Class are (i) Defendants; (ii) members of the immediate family of each Individual Defendant;  
2 (iii) any person who was an officer or director of WaMu, the Auditor Defendant, or any of the  
3 Underwriter Defendants during the Class Period; (iv) any firm, trust, corporation, officer, or  
4 other entity in which any Defendant has or had a controlling interest; (v) any person who  
5 participated in the wrongdoing alleged herein; (vi) purchasers of the equity securities issued by  
6 WaMu in connection with the \$7 billion capital issuance pursuant to the agreements entered into  
7 by and among TPG Capital and WaMu and other investors as announced by the Company on  
8 April 8, 2008 (the "TPG Deal"), to the extent that such purchasers acquired and/or converted  
9 their securities pursuant to the Registration Statement filed with the SEC on or about May 2,  
10 2008 and as described in the Form SC 13D filed with the SEC on July 3, 2008 as well as in the  
11 Company's April 15, 2008 and July 2, 2008 press releases<sup>4</sup>; and (vii) the legal representatives,  
12 agents, affiliates, heirs, beneficiaries, successors-in-interest, or assigns of any such excluded  
13 party.  
14  
15

16 52. The Class is so numerous that joinder of all Class members is impracticable. The  
17 disposition of their claims in a class action will provide substantial benefits to the parties and the  
18 Court. Throughout the Class Period, WaMu's common stock was actively traded on the NYSE,  
19 which is an efficient market. As of January 31, 2007, there were over 880 million shares of  
20 WaMu common stock outstanding. While the exact number of Class members is unknown to  
21 Lead Plaintiff at this time, and can only be determined through appropriate discovery, Lead  
22 Plaintiff believes that Class members number in at least the hundreds of thousands.  
23  
24  
25

26 <sup>4</sup> These purchasers are excluded as atypical of the Class due, at least in part, to the distinct rights  
27 and opportunities afforded them in connection with the TPG Deal.

53. The claims of Plaintiffs are typical of the claims of other Class members. Plaintiffs and all Class members acquired their WaMu securities shares on the open market or pursuant to the Offerings and sustained damages as a result of Defendants' conduct alleged herein in violation of the federal securities laws.

54. Lead Plaintiff will fairly and adequately protect the interests of the Class members and have retained counsel competent and experienced in class action and securities litigation. Plaintiffs have no interests that are contrary to or in conflict with those of the Class.

55. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the Class members individually to seek redress for the wrongful conduct alleged herein.

56. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class predominate over questions that may affect individual Class members. Such common questions of law and fact, include, among others:

- (a) Whether Defendants violated the federal securities laws;
- (b) Whether documents, press releases and public statements made by the Defendants during the Class Period concerning the Company's financial and operational position, including statements concerning the Company's financial results, contained misstatements of material fact or omitted to state material facts necessary in order to

make the statements made, in light of the circumstances under which they were made, not misleading;

(c) Whether WaMu's SEC filings issued during the Class Period which contained financial information (*i.e.* its Forms 10-K, 10-Q, 8-K, and S-3) contained untrue or materially misleading statements;

(d) Whether the market prices of WaMu securities during the Class Period were artificially inflated due to the material misrepresentations complained of herein;

(e) Whether with regard to claims under the Exchange Act, certain of the Defendants knew or recklessly disregarded that their statements were false and misleading;

(f) Whether the Offering Documents (as defined below) contained material misstatements or omitted to state material information; and

(g) Whether Class members have sustained damages and, if so, the appropriate measure thereof.

57. Lead Plaintiff knows of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

58. The names and addresses of record owners of WaMu securities purchased on or traceable to the Offerings and during the Class Period are available from records maintained by WaMu or its transfer agent. Notice may be provided to such record owners via first class mail, using techniques and a form of notice similar to that customarily used in securities class actions.

## VI. FACTUAL BACKGROUND AND SUBSTANTIVE ALLEGATIONS

### A. WaMu and Its Core Home Lending Business

59. The focus of this action, WaMu's residential lending business, was a driving force of WaMu's overall operations during the Class Period. It is beyond dispute that WaMu's lending operations were a significant contributor to the Company's income and also generated a substantial portion of the Company's assets. For example, in both its 2006 Form 10-K, filed with the SEC on March 1, 2007, and its 2007 Form 10-K with SEC, filed on February 29, 2008, the Company stated that almost 70% of its net interest income was generated by residential real estate loans and related products. Similarly, in its Forms 10-K for 2006 and 2007, WaMu also stated that over 60% of the Company's overall average assets were generated by residential real estate loans and related products.

60. Throughout the Class Period, WaMu originated – that is, “sold” to its borrowers – residential loans through its retail and wholesale lending operations, which were primarily issued through WaMu's Home Loans and Commercial Groups.

61. As a requirement to a WaMu home loan becoming effective, or “closing,” WaMu had to underwrite and approve the loan. That is, WaMu must ensure that the borrower qualifies for the loan product in question under the Company's underwriting standards, based upon documentation of the borrower's credit history and score, income, debt level, and other factors. As explained in detail in Section VI.C below, a critical requirement in residential loan underwriting is the home appraisal, which is supposed to be an independent assessment of the market value of the real estate pledged by the borrower as collateral against the WaMu loan.

62. After originating home loans, WaMu either (a) retained the loans as investments in its “held for investment” portfolio, which generally were reflected as assets in the Company's

1 public financial reports and in other information disseminated to the public; or (b) held such  
2 loans for sale, and, accordingly, securitized or otherwise sold off such loans to third parties in  
3 due course, primarily through the Capital Markets Division of WaMu's Home Loans Group  
4 ("WaMu Capital Corp.").

5  
6 63. As noted above, WaMu reported significant income from its home lending  
7 operations during the Class Period. With regard to its loans "held for investment," however, as  
8 explained in detail in Section VI.E, WaMu was also required to maintain and publicly report a  
9 reserve amount for probable losses related to such loans (for example, losses from WaMu  
10 borrowers defaulting on their obligations to make mortgage payments). WaMu referred to its  
11 loss reserve as its Allowance for Loan and Lease Losses (the "Allowance"). WaMu's Allowance  
12 was one of only five "earnings drivers" that the Company discussed each quarter, and was a  
13 critical metric for investors because, as the Company's 2006 Form 10-K explained, "[t]he  
14 [Allowance] represents management's estimate of incurred credit losses inherent in the  
15 Company's loan and lease portfolios as of the balance sheet date." As explained in greater detail  
16 in Section VI.E, below, WaMu was required to periodically reassess and adjust its Allowance, or  
17 "provision," for any such loan and lease losses. Increases in the Allowance reduce, dollar for  
18 dollar, WaMu's earnings because such charges are recorded as an expense. Therefore, WaMu's  
19 reported Allowance was directly linked to net income and the Company's earnings per share.

20  
21  
22 64. Throughout the Class Period, WaMu made representations and warranties  
23 concerning the quality of WaMu's loans to third-party purchasers of its residential loans. The  
24 quality of WaMu's loans was, for readily-apparent reasons that include expected return and risk  
25 concerning such loans, important to third-party purchasers of WaMu loans. In the event that  
26 such purchasers were to determine that the Company had breached its representations and  
27

warranties, or if a borrower defaulted early in the term of the loan, such purchasers may hold WaMu accountable for losses related thereto by requiring WaMu to repurchase the loans. WaMu was also required to maintain an appropriate reserve for such losses.

**B. WaMu Abandons Customary Lending and Business Practices  
in Favor of Much Riskier Loan Products and Company  
Policies**

65. In 2005, WaMu publicly announced, for the first time, its landmark, ambitious five-year plan for the Company. According to a February 28, 2005 press release, WaMu's plan called for "[t]ransforming the company's mortgage business and maintaining a leading national position in mortgage lending," while also "[m]aintaining risk management as a top priority."

66. WaMu's new plan coincided with the ascendancy of a new senior management regime at WaMu. While Defendant Killinger maintained his long-standing position as both CEO and Chairman of WaMu's Board, in January of 2005, Defendant Rotella joined the Company as President and Chief Operating Officer. Defendant Rotella became the acting president of the Home Loans Group in March as well. In July of 2005, Defendant Schneider was appointed as the President of the Home Loans Group. By the end of 2005, among other changes in senior management, the Company also installed a new Chief Enterprise Risk Officer, Defendant Cathcart, and a new Controller, Defendant Woods.

67. At the same time, as detailed below, the Company began to promote riskier loan products to both prime borrowers (*i.e.*, as discussed in Section VI.D.1, borrowers who appeared to be substantially creditworthy) and subprime borrowers, while reducing the share of traditional, fixed rate loans it originated. Specifically, during the Class Period, the Company focused heavily on originating loan products, such as WaMu's "flagship" product, the Option ARM loan, and subprime loans that were "nonconforming"; that is, they did not meet the specifications

1 required by the government-sponsored entities (“GSEs”), such as Freddie Mac or Fannie Mae.  
2 Traditionally, the GSEs provided liquidity to the home mortgage market by purchasing  
3 conforming loans and, in certain cases, securitizing the loans. Conforming loans impose certain  
4 standards, such as specific debt-to-income ratio limits and documentation requirements.  
5 Nonconforming loans, on the other hand, may be for much larger dollar amounts than  
6 conforming loans and made to less credit-worthy buyers. Because these nonconforming loans  
7 were riskier, WaMu could charge much higher interest rates and fees for their origination.  
8

9 68. While WaMu acknowledged publicly that it had altered its loan origination mix in  
10 favor of generating more loans with higher profit margins, WaMu and the other Defendants did  
11 not come close to revealing the full extent of WaMu’s actual plans and business practices during  
12 the Class Period. As explained below, with the start of the Class Period, WaMu’s concerted  
13 efforts to transform itself from a sleepy savings and loan into a high-margin bank began to  
14 include highly questionable and unlawful practices directed by the Officer Defendants. These  
15 practices were implemented by the Officer Defendants to artificially fuel the growth that WaMu  
16 craved for their own personal short-term gain, all at the expense of WaMu investors.  
17

18 69. The truth gleaned through Lead Plaintiff’s investigation is the result, in part, of  
19 numerous interviews with former employees who themselves witnessed the wrongdoing alleged  
20 herein. These include former employees of WaMu, eAppraiseIT, and LSI. These witnesses are  
21 referred to as Confidential Witnesses or “CWs,” each with its own unique identifying number.  
22 Appendix 1 provides a summary of relevant information concerning each CW, including, as  
23 appropriate, the position(s) held by each CW, the time period during which each CW was  
24 employed, and a general description of the duties and responsibilities of the CW, if relevant. As  
25 Judge Posner recently noted in *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 712  
26  
27



(7th Cir. 2008), where confidential witnesses are “numerous and consist of persons who from the description of their jobs were in a position to know at first hand the facts to which they are prepared to testify . . . the absence of proper names does not invalidate the drawing of a strong inference from informants’ assertions.” Furthermore, should the Court so request, Lead Counsel will provide the identity of the confidential witnesses to the Court *in camera*.

70. Former long-time WaMu employees have described how, around the start of the Class Period, WaMu’s most senior management in Seattle abandoned fundamental concepts of underwriting and risk management in order to satisfy the Officer Defendants’ hunger for ever-greater loan volume. For example, CW 1, who worked at WaMu for over 17 years from 1991 until April 2008 as a Due Diligence Director in the Transaction Management Group in Anaheim and Fullerton, California, explained how, beginning in 2006, management in Seattle lost “sight of the basic tenants of underwriting and risk.” Indeed, as a Due Diligence Director, CW 1 was responsible, among other duties, for all aspects of the due diligence process regarding prime, Alt-A, and subprime mortgages for the Company’s held for investment portfolio. A key aspect of CW 1’s role at the Company was to ensure that effective processes were in place to identify, assess, and quantify existing and emerging risks and offer solutions to mitigate those risks. CW 1 stated that the results of these analyses and suggested solutions to mitigate risks were reported to senior management in Seattle. CW 1 explained how, notwithstanding the reporting structure that was in place, beginning in 2006, with the Company’s focus on amplifying loan volume in an effort to generate more money, management in Seattle abandoned “the basic tenants of underwriting and risk.” Specifically, CW 1 explained that WaMu’s senior management was so intent on increasing loan volume and on acquiring and securitizing more mortgages that

1 management in Seattle disregarded the “warning signs” and “several red flags” apparent to them,  
2 even in early 2006, of the “increased risks that the Company was entering into.”

3 71. CW 1 further stated that the significant problems at WaMu resulted from senior  
4 management choosing to ignore the basic structure and safeguards that were already in place in  
5 furtherance of their own ambition for growth and the monetary rewards it brought to them.  
6

7 72. Other long-time WaMu employees echoed CW 1’s sentiments, albeit from their  
8 own roles and vantage points within the Company. For example, Confidential Witness 2 worked  
9 at WaMu for over twelve years, from 1995 until 2008. From 2005 to 2008, CW 2 was employed  
10 as an Underwriting Supervisor by WaMu in Bellevue, Washington. Prior to that time, CW 2  
11 worked as a Senior Credit Analyst with WaMu from 2003 through 2005, and prior to that role  
12 CW 2 was a Senior Loan Coordinator with WaMu from 1997 to 2003. CW 2 observed a marked  
13 deterioration in WaMu’s underwriting standards and practices for the Company’s prime loans  
14 starting in 2005, subsequent to WaMu’s hiring of Defendant Rotella as President and Chief  
15 Operating Officer of WaMu in early 2005. According to CW 2, she and other long-time WaMu  
16 employees could “sense the change” initiated by the Officer Defendants. Regarding the  
17 increased risks the Company was taking on at the Officer Defendants’ behest, CW 2 observed  
18 that “common sense took a vacation.” Similarly, CW 3, a former WaMu Assistant Vice President  
19 and Branch Manager in California from 1996 until early 2008, described WaMu’s loan approval  
20 process after 2005 as “very scary.” In particular, CW 3 stated that, starting in 2005, the  
21 Company’s loan approval process became “very lenient” and allowed employees to do  
22 “whatever” was necessary “to get a loan approved.” CW 3 described the Company’s  
23 widespread leniency as disturbing, stating, “[i]t was very scary to me at the company to see these  
24 types of things going on.”  
25  
26  
27

73. Consistent with the observations of these insiders and other described below, throughout the Class Period, WaMu, at the direction of the Officer Defendants, secretly inflated appraisal values in connection with its lending, materially loosened its underwriting standards without disclosure, and also discontinued appropriate risk management that was supposed to be in place to prevent such policies. In addition to these practices, Defendants, in violation of law and GAAP, caused WaMu to under-reserve for losses that were probable – if not entirely foreseeable – in light of the foregoing highly reckless practices. These facts are described in further detail below.

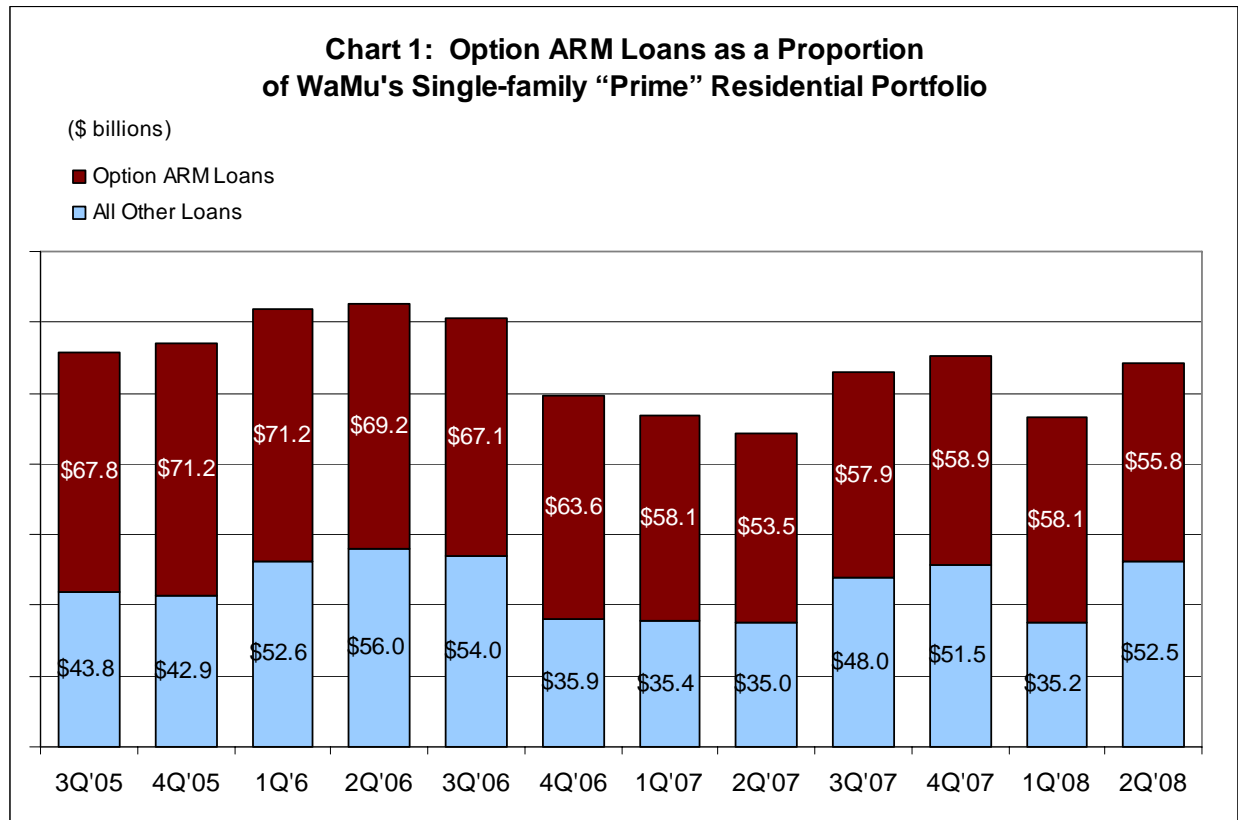
### 1. WaMu's Risky, Nontraditional Loan Products

74. In order to maximize the Company's loan volume and the appearance of growth and profitability, WaMu strayed from traditional, high-quality, and fixed-rate lending to promote instead numerous types of nontraditional loans. Principal among WaMu's exotic loans were its Option ARM loans, a form of adjustable rate mortgage (ARM) loans (a loan where, instead of a fixed rate of interest, the interest rate is periodically adjusted over the term of the loan based on indices such as Treasury securities or the London Interbank Offered Rate ("LIBOR")). As explained in greater detail below, Option ARM loans were unique among ARM loans in that they give the borrower the option each month to make either a full, interest-only, or a "minimum payment." *Option ARMs were WaMu's self-proclaimed "flagship product" and made up the majority of WaMu's "prime" mortgage originations during the Class Period, as well as the majority of the loans in WaMu's "held for investment" portfolio of loans.*<sup>5</sup> Chart 1 below illustrates that throughout the Class Period, Option ARM loans *always* made up more than fifty

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<sup>5</sup> Throughout this Complaint, emphasis has been added unless otherwise stated.

percent of WaMu's held for investment loan portfolio. For example, as illustrated below, in the fourth quarter 2006, Option ARM loans comprised \$63.6 billion – or 64% – of WaMu's entire \$99.5 billion loan portfolio.



75. WaMu's Option ARM minimum payment option is based on the interest rate charged during the introductory period, and is almost always significantly lower than the loan's fully-indexed payment rate. The fully-indexed rate is calculated using an index rate plus a margin. When the introductory or "teaser" period ends, typically after a period of several months, the contractual interest rate charged on the loan increases to the fully-indexed rate and adjusts monthly to reflect movements in the index. For example, a teaser rate of 1.75% on a \$350,000, 30-year loan would yield an initial monthly payment of approximately \$1,250. Once the rate adjusts to the fully-indexed rate on the same loan, for example, to a rate of 7.0%, the

1 monthly payment would increase from \$1,250 to a monthly payment of approximately \$2,329 –  
2 an approximate monthly increase for the borrower of over \$1,079, or nearly twice borrower's  
3 initial payment.

4 76. If a WaMu Option ARM borrower continues to make only a minimum monthly  
5 payment after the introductory period ends, his or her payments may not be sufficient to cover  
6 the interest accrued on his or her loan. This results in so-called "negative amortization" of the  
7 Option ARM loan as unpaid interest is deferred and added to the loan's principal balance.  
8 During the Class Period, WaMu "capped" the amount of negative amortization on its Option  
9 ARM loans from 100% to 125% of the original loan balance. So if a WaMu borrower reaches  
10 the negative amortization cap (or at least every 60 months), the borrower's WaMu loan was  
11 subject to "recasting," where a new minimum monthly payment is calculated that is sufficient to  
12 fully repay the principal balance of the loan, including any theretofore deferred interest, over the  
13 remainder of the loan term using the fully-indexed rate then in effect.

16 77. WaMu booked negative amortization amounts on its Option ARM loans as  
17 deferred interest earnings on its income statement, *thereby reporting non-cash income created*  
18 *solely from a borrower's failure to pay full interest*. As a result, explained Confidential Witness  
19 4, a former account executive for LBM in New Jersey for more than four years from April 2003  
20 to September 2007, Option ARM loans were known internally at WaMu as "the portfolio  
21 product" because WaMu could keep its Option ARM mortgages in-house on the Company's  
22 books and record the deferred interest from them as income. During the Class Period, the unpaid  
23 Option ARM principal balance, which was recorded by WaMu as non-cash income, rose from  
24 \$76 million in the third quarter 2005 to \$1.7 billion in the fourth quarter 2007.

1           78. During the Class Period, as alleged in detail below, the Company falsely  
2 represented that it was managing the Company's risk associated with its Option ARM products  
3 by ensuring compliance with appropriate underwriting standards, appropriately monitoring loan  
4 performance and conducting risk modeling procedures, when in fact it was not doing so. For  
5 example, although the Company claimed that it did not offer Option ARM loans to subprime  
6 borrowers, as alleged in greater detail below, WaMu in fact issued Option ARM loans to  
7 borrowers with credit scores as low as 540, when any credit score below 660 is generally  
8 considered subprime. Moreover, as discussed below, WaMu inappropriately underwrote many of  
9 its Option ARM loans at the loan's introductory interest rate, rather than, as the Officer  
10 Defendants continually represented throughout the Class Period, at the loan's fully-indexed  
11 interest rate. In other words, WaMu often qualified its Option ARM borrowers based their ability  
12 to pay temporary, very low "teaser" interest rates rather than the much higher interest rates that  
13 would be in place for the overwhelming majority of the Option ARM loan term.  
14

15           79. WaMu also offered stated-income loans, which are mortgages in which the lender  
16 does not verify the borrower's income by examining their pay stubs, W-2s, bank statements, tax  
17 documents or other records. Instead, WaMu simply asked the borrower for his or her income and  
18 took any such representations at face value. Due to the lack of verification, stated-income loans  
19 are particularly risky. While these loans were initially intended for self-employed borrowers  
20 with good credit, WaMu extended them even to subprime borrowers. Similarly, "no-doc" or  
21 "low-doc" loans refer to loan products offered to borrowers that require little to no  
22 documentation from the borrower. When these loans were extended to borrowers with  
23 purportedly good credit who simply did not wish to offer documentation, WaMu referred to them  
24 as "Alt-A" loans. These types of loans were often called "liar loans."  
25  
26  
27

1           80.     WaMu extended subprime mortgage loans, which are mortgages that are offered  
2 to relatively less creditworthy borrowers, and, like the various non-traditional ARM products  
3 described above, typically cannot be sold to GSEs such as Fannie Mae and Freddie Mac.  
4 Subprime lending is risky for lenders due to the frequently poor credit histories of subprime  
5 borrowers, and the higher interest rates that typically are charged for such loans. Throughout the  
6 Class Period, the Company falsely stated in its annual SEC filings that it mitigated credit risk in  
7 its subprime lending through careful underwriting.

8  
9           81.     In addition to the types of exotic and risky loans described above, WaMu also  
10 offered loans that did not require a down payment, so-called “100% LTV loans,” and “80/20  
11 loans” (where the buyer took out two loans, one for the 80% of the purchase price and another  
12 for 20% of the purchase price, to avoid requiring the borrowers to obtain paying private  
13 mortgage insurance (“PMI”)); “hybrid ARMs,” where the initial interest rate is fixed for some  
14 period of time, usually two to five years, and then “floats,” or changes according to an  
15 established banking index, thereafter; home equity lines of credit (“HELOCs”), which allowed  
16 homeowners to leverage existing equity in their homes by borrowing money either through a first  
17 or second lien loan or line of credit; WaMu mortgage plus<sup>TM</sup> loans, introduced in April 2007,  
18 which combined a first mortgage and HELOC into a single loan, among other features; and  
19 interest-only (“IO”) payment loans, which required borrowers to pay an amount sufficient only  
20 to cover the amount of interest accrued in the previous month, and then after a predetermined  
21 period of time (usually 5 years), the payment is reset to allow the loan to fully-amortize over its  
22 remaining life.

23  
24  
25           82.     Although WaMu and the Officer Defendants claimed that WaMu issued the loans  
26 described above only to borrowers that WaMu deemed qualified after “rigorous” underwriting  
27

1 for each of these exotic loan products, as can be seen throughout this Complaint, as a matter of  
2 policy the Company in fact actively took undisclosed, unlawful and unsafe measures to increase  
3 its volume of such loans.

4  
5 **2. WaMu Aggressively Pushed Risky Loans  
on Borrowers for Defendants' Gain**

6 83. WaMu, at the direction of the Officer Defendants, established a system of  
7 financial rewards for originating higher-risk loans, and corresponding negative consequences for  
8 those who did not toe the Company line. As explained immediately below, WaMu loan  
9 production personnel were compensated based on loan volume without any regard to loan  
10 quality, and were paid even more for originating riskier loans, including Option ARM loans.  
11 WaMu's employees, accordingly, targeted more and more borrowers who were less able to afford  
12 the loan payments they would have to make, and many of whom had no realistic ability to meet  
13 the obligations incident to the loans they were sold.  
14

15 84. WaMu's loan volume-based compensation policies were explained – and openly  
16 questioned – by a number of former WaMu employees contacted in the course of Lead Plaintiff's  
17 investigation. As Confidential Witness 5, a former Senior Underwriter, Credit Risk Manager,  
18 and Credit Quality Manager at WaMu's Bellevue, Washington wholesale and retail loan  
19 fulfillment center from 2003 until February 2008, explained with regard to WaMu's loans, "[t]he  
20 more you slammed out, the more you made."  
21

22 85. Also, Confidential Witness 6, Senior Loan Consultant with WaMu from 2005 to  
23 2007, observed that sometimes loan originators were surprised by what loans they could get  
24 approved; however, as a loan officer, if CW 6 could personally earn \$2,000 - \$3,000 by closing a  
25 loan, then CW 6's only concern was getting the loan approved. The lesson learned within  
26 WaMu, according to CW 6, was: "Once you get paid, you don't care what happens."  
27



1           86. Other former employees agreed that the primary factor driving WaMu's mortgage  
2           lending practices was to produce as much volume as possible. Confidential Witness 7, who was  
3           a Closing Loan Coordinator in Bethel Park, Pennsylvania, from 2003 until July 2007, stated that  
4           WaMu's priority regarding loans was "always quantity rather than quality." According to CW 7,  
5           during the Class Period, the Bethel Park branch regularly closed an "insane" volume of loans per  
6           day. WaMu could meet these volume expectations only by neglecting traditional underwriting  
7           standards – as CW 7 put it, "[i]f you flew by the seat of your pants and didn't look at everything,  
8           you could get it done." Consistent with the reports of numerous other former WaMu employees,  
9           CW 7 reported that WaMu management constantly pressured underwriters to close as many loans  
10          as possible. Underwriters were given the freedom to waive many conditions for approval of  
11          loans, such as required assets and debt-to-income requirements. According to CW 7, WaMu  
12          managers "tried to appease the loan officers" and underwriters "definitely waived conditions  
13          they should not have waived." CW 7 observed that the branch head was most concerned with  
14          "look[ing] good among her peers" by "hitting certain numbers every month." WaMu rewarded  
15          high-performing loan officers with "fabulous vacations" if they made their numbers. CW 7  
16          summed up the culture at WaMu as follows: "It was all about sell, sell, sell."

17  
18  
19          87. Loan originators were not only compensated for volume without regard for  
20          quality – they were paid more for originating loans that carried higher profit margins for the  
21          Company and had commensurately higher credit risk. For example, Confidential Witness 8, a  
22          Senior Loan Consultant with WaMu at Riverside, CA, from 2005 through December 2007,  
23          reported that, "every year [WaMu] came out with a new commission outline and [WaMu's] extra  
24          commissions for teaser rate loans." Further, according to CW 8, occasionally WaMu would send  
25          out emails to loan originators about commission "specials." One of WaMu's "specials," CW 8  
26  
27

1 recalls, was to give loan originators extra commissions for Option ARM loans. In addition,  
2 WaMu paid additional commissions for non-conforming loans. According to CW 8, at WaMu  
3 “[i]t’s not about what’s best for the client; it’s about what’s best for the Company.” CW 8, who  
4 served as a Senior Loan Consultant for the Company from September 2005 until December  
5 2007, also noted that WaMu’s higher risk loans always came with increased commissions.

6  
7 88. Similarly, Confidential Witness 9, a former Senior Loan Coordinator for WaMu’s  
8 Home Loan Center in Bethel Park, Pennsylvania from February 1998 through September 2007,  
9 elaborated on WaMu’s volume-based compensation for its loan originators. CW 9 stated that  
10 “WaMu’s top priority was to get as many loans closed as quickly as they could close and not  
11 worry – they just wanted the volume, and it didn’t seem to matter how they got it . . . .  
12 Everybody just wanted their chunk of the money.”

13  
14 89. CW 9 recalled that near the end of 2006, WaMu started rapidly introducing new  
15 programs – “[second loans] were constantly being thrown in with all the firsts . . . it seemed  
16 every file was coming over with a second attached,” which led to high combined LTV ratios for  
17 loans issued to WaMu borrowers. CW 9 explained that during the Class Period, “[I]t got really  
18 bad. You saw a lot of Adjustable Rate Mortgages – we always had them, but they were not a big  
19 item, and then all of a sudden they became real popular, then everything that was coming in was  
20 an ARM loan with a second attached – I could see why people were losing their homes – all it  
21 was greed, you could see it in the loan officers.” CW 9 also noted that “a lot” of the borrowers  
22 “didn’t even understand what [an ARM] was” and CW 9 would “feel bad for the customers.”

23  
24 90. According to CW 9, not only did loan coordinators receive bonuses for loans they  
25 closed, but CW 9 understood that if loan officers did not meet their loan volume quota, WaMu  
26 fired them.

1           91. In fact, intense pressure from WaMu management to close loans – WaMu’s  
2 “stick” – went hand-in-hand with WaMu’s rich incentives for its salespeople to originate the  
3 maximum number of loans possible. As numerous former WaMu employees reported below,  
4 WaMu management leaned heavily on WaMu’s personnel to “close” loans at all costs. In other  
5 words, WaMu management pressured its employees to do whatever was necessary – including,  
6 as set forth below, disregarding Company underwriting policies and approving wide-ranging  
7 exceptions to underwriting guidelines – to close loans. According to Confidential Witness 10, a  
8 Loan Coordinator/Mortgage Processor for WaMu in 2007, there was a Company-wide culture  
9 that required WaMu employees to do “whatever it took to get loans closed.” WaMu managers  
10 would constantly convey to WaMu underwriters and salespeople that they had to “push, push,  
11 push” to close loans.  
12

13           92. CW 10 reported that WaMu loan originators were instructed by their WaMu  
14 managers that if there were problems with underwriters in getting loans closed to bring loan files  
15 to WaMu managers – WaMu’s policies encouraged loan production management to see to it that  
16 the loan went through.  
17

18           93. Similarly, Confidential Witness 11, a Senior Loan Coordinator with WaMu in San  
19 Antonio from November 2006 to June 2007, recalled “tremendous pressure from the sales guys  
20 to approve loans” and that, with the involvement of WaMu management, even questionable loans  
21 “usually got taken care of one way or another.” CW 11 further explained that WaMu’s loan sales  
22 personnel and their managers were “above [WaMu’s] loan processors,” and therefore WaMu’s  
23 loan processors “were supposed to yield to whatever their needs were.”  
24

25           94. Confidential Witness 12, a former Loan Consultant for WaMu in Riverside,  
26 California, reported that because of WaMu’s additional incentive compensation, WaMu  
27

1 salespeople undertook particularly aggressive tactics to sell Option ARM loans. As CW 49 put  
2 it, “WaMu’s biggest things are ARMs – they push those things like cotton candy.” According to  
3 CW 12, “most borrowers” who came to WaMu “wanted the fixed rate loans.” Thus, selling  
4 Option ARM loans required “pushing” them. According to CW 12, this “pushing” was done in a  
5 “nasty” way. WaMu loan officers would fail to educate the borrower, so that Option ARM loan  
6 borrowers “would think they were paying the fully-indexed rate, when they were only paying a  
7 portion of the interest” because the loan consultants did not explain the programs thoroughly.  
8 WaMu loan consultants were under “a lot of pressure” from their managers to promote and sell  
9 Option ARM loans. CW 12’s conscience limited CW 12 to originating only “one or two” Option  
10 ARM loans because CW 12 was so opposed to these “risky” loans. As a result, CW 12 was  
11 frequently reprimanded by CW 12’s managers at WaMu.  
12

13  
14 95. Likewise, Confidential Witness 13, a Sales Manager with WaMu for twenty years  
15 until October 2006, was “bothered” by the fact that WaMu incented loan officers to push Option  
16 ARM loans on WaMu loan applicants. According to CW 13, WaMu managers also received  
17 increases in their bonuses if they closed a certain percentage of Option ARM loans. According  
18 to CW 13, the incentives to promote and close Option ARM loans remained “pretty consistent”  
19 over the Class Period: it was clear to WaMu sales managers that WaMu wanted to “drive” as  
20 many borrowers as possible into Option ARM loans.  
21

22 96. Indeed, it was not unusual for WaMu to fail to educate borrowers on the dangers  
23 of Option ARM loans. This was so notwithstanding Defendant Killinger’s statement that, “[w]e  
24 understand that the best mortgage customer is a well-informed borrower and that’s why we focus  
25 on providing clear, understandable disclosures for our customers and ongoing training for our  
26 sales force. . . . [T]he quality of our option ARM portfolio remains strong.”  
27

1           97. In truth, WaMu customers were confused by the Company's complex and ever-  
2 changing loan products and were often convinced to commit to adjustable-rate loans with the  
3 misunderstanding that the "teaser" rate was the loan's rate for its entire length. Indeed,  
4 according to CW 7, who was a Closing Loan Coordinator in Bethel Park Pennsylvania, WaMu's  
5 Option ARM products "were not explained properly to the buyer, so they didn't know the rate  
6 was going to go up." CW 5 believed that the "majority" of Option ARM loan borrowers did not  
7 understand that their payment would increase from the initial teaser rate.  
8

9           98. Confidential Witness 14 was an employee at WaMu from 1993 to 2006 and was a  
10 "Senior Trainer" from 2000-2004, training employees on processing, closing, underwriting,  
11 leadership, products, and pricing. CW 14 found the products WaMu was pushing to be  
12 problematic, particularly the Option ARM. According to CW 14, Option ARM loans were  
13 suitable only for rental, non-owner occupied properties or for "savvy investment people who  
14 play the stock market." However, many of the WaMu sales people in CW 14's class did not  
15 understand the concept of negative amortization and could not explain it to borrowers. Contrary  
16 to their public statements, the Company was more concerned with increasing loan volume than  
17 ensuring that borrowers actually understood the terms of their loans and therefore that the loans  
18 were being originated to borrowers who could not repay them.  
19

20           99. Indeed, a WaMu presentation on Option ARM loans, obtained through Lead  
21 Plaintiff's investigation, makes it clear that WaMu's focus was not on the borrower's  
22 understanding of the loan's terms or ability to repay the loan. The presentation was entitled:  
23 "Washington Mutual Option ARM: At last a mortgage that puts your clients in control of their  
24 monthly payments." The WaMu presentation announces that appropriate "Option ARM  
25 Candidates" are:  
26  
27

- Savvy Investors
- *First Time Home Buyers*
- High Income Earners
- *Self Employed Borrowers*
- *Retired Borrowers*
- Real Estate Agents

In other words, contrary to its public statements, WaMu pushed its Option ARM loans on borrowers regardless of their sophistication and income levels or stability.

100. In addition, WaMu sought to sell exotic loans to borrowers who did not want or need such loans, but were convinced to take them by WaMu salespeople. CW 7 recalls that Donna Krall, a WaMu Retail Operations Director, visited the Bethel Park, Pennsylvania branch and impressed upon the loan officers the importance of “pushing” home equity loans. According to CW 7, Krall “put the pressure on” loan officers to “try to talk [borrowers] into home equity loans. Instead of mortgage insurance, they would push two loans.” Because of the Company’s compensation promotions, these second loans meant “monetary gain for the loan officers.” Indeed, according to CW 7, these home equity loans regularly failed the regular audits performed by WaMu on selected loans – WaMu “never got to the point where the [home equity] loans were passing the audits.” However, home equity loans, like all second liens, were particularly dangerous if made to non-creditworthy borrowers. These loans are typically reserved for borrowers with good to excellent credit scores. However, CW 6 recalls a WaMu “First Lien Home Equity” product that focused specifically on non-owner or investment properties, or typically second homes. For that product, according to CW 6, WaMu was providing loans that equaled 90% of the total value of the homes in question. CW 6 called this standard “unheard of” in the industry and extremely risky.

1           101. WaMu's LBM employees were also compensated for increasing loan volume, not  
2 for decreasing, or even considering, credit risk. Confidential Witness 15 was a First Vice  
3 President in the Capital Markets Group at WaMu Capital Corp. in New York, New York, from  
4 October 2004 until December 2007. CW 15 was in charge of Investor Relations, and responsible  
5 for working with the various investors in the securitized subprime products being structured and  
6 issued by the capital markets area. CW 15 reported directly to Doug Potolsky and, as a senior  
7 management level employee, had close interaction with David Schneider and other senior  
8 executives within the Home Loans Group. According to CW 15, WaMu specifically  
9 compensated the account executives and the underwriters at WaMu's LBM based on the volume  
10 of loans that they brought in and closed, with no consideration in their compensation structure  
11 relating to the quality of those loans. According to CW 15, this practice led to many  
12 questionable tactics to simply increase loan volumes.  
13  
14

15           102. Based on their direct experience with WaMu during the Class Period, former  
16 employees described WaMu's residential mortgage operations as "crooked" and "underhanded."  
17 For example, CW 16, a former WaMu employee from 1999 to 2006, who held numerous  
18 positions including Senior Appraisal Coordinator for properties located in California, Florida,  
19 Texas and Washington, said that WaMu's "residential mortgage side was very crooked."  
20 Specifically, CW 16 stated that the residential mortgage division was especially underhanded in  
21 Orange County and Southern California, where, according to CW 16, WaMu "raped and robbed  
22 the people," especially Latinos. CW 16 further explained that WaMu's residential mortgage  
23 operations were so crooked that "many WaMu employees absolutely refused to get their  
24 residential loans through WaMu."  
25  
26  
27

### 3. Defendants Discontinued Effective Risk Management During the Class Period

103. Just as the Company was deliberately shifting toward higher-margin, high-risk loan products, WaMu and the Officer Defendants made an equally deliberate choice to shift the Company's risk management focus from being a "regulatory burden" to a sales-supporting, "customer service" role.

104. According to the Company's regulatory filings, WaMu's Enterprise Risk Management supposedly:

works with the lines of business to establish appropriate policies, standards and limits designed to maintain risk exposures within the Company's risk tolerance. Significant risk management policies approved by the relevant management committees are also reviewed and approved by the Audit and Finance Committees [of the Board]. Enterprise Risk Management also provides objective oversight of risk elements inherent in the Company's business activities and practices and oversees compliance with laws and regulations.

Beginning in the fourth quarter of 2005, Defendant Cathcart was the head of WaMu's Enterprise Risk Management. When Defendant Cathcart was hired in November 2005 to lead Enterprise Risk Management, Defendant Killinger announced, "Ron has a proven track-record in developing and leading risk management organizations . . . . He is a seasoned professional with a deep understanding and familiarity with all facets of risk management." Cathcart replaced James Vanasek, who had been the Company's Chief Enterprise Risk Officer since 2004.

105. As part of the Company's initiative – as led by the Officer Defendants – to transform WaMu into a high-growth, high margin business, WaMu secretly discontinued appropriate risk management practices during the Class Period. As explained in detail below, WaMu's risk management operations were purposefully pulled back, starting in late 2005, to such a degree that WaMu's risk management systems and personnel could no longer effectively protect the Company's investors from the increased risks that WaMu and the Officer Defendants



1 began to take on no later than the start of the Class Period. These looming risks then manifested  
2 themselves in several ways, including WaMu's highly irresponsible, volume-driven home  
3 lending, and its attendant wrongful appraisal and underwriting practices. Significantly, as  
4 explained in Section VI.E, even when WaMu's risk management teams identified critical  
5 problems with WaMu's business and accounting practices and brought those matters to the  
6 attention of WaMu's senior management, appropriate remedial actions were not taken.  
7

8 106. Confidential Witness 17 served as a Senior Vice President of WaMu's Enterprise  
9 Risk Management group from August 2001 until he chose to leave WaMu in September 2006.  
10 CW 17 came to WaMu in 2001 with over fifteen years of significant risk management and  
11 quantitative modeling experience at other major financial institutions. CW 17 managed a team at  
12 WaMu of approximately 35 quantitative analysts involved in various risk management functions,  
13 including compliance, performance measurement, quantitative analysis and risk reporting, and  
14 model validation. In general, CW 17 explained, his group had overall responsibility for  
15 establishing risk management policies, corporate governance and reporting frameworks. CW 17  
16 explained that until WaMu began to cause its risk management policies and practices to  
17 deteriorate in late 2005, he was responsible for "enhancing the Company's quantitative modeling  
18 capabilities." CW 17 explained that his group's original purpose was to establish and maintain  
19 "a high-level of quantitative analysis through the institution" but, as explained below, those  
20 efforts were "undermined when [Defendant] Cathcart took over the group in 2006."  
21

22 107. CW 17 confirmed that, with efforts that began in late 2005 and that were largely  
23 spearheaded by Defendant Cathcart, WaMu "diverted from its original mandate" to guard against  
24 risk. For example, CW 17 explained that Defendant Cathcart managed "a specific initiative to  
25 move the risk management functions down into [WaMu's] business units," which, for example,  
26  
27

led to the establishment of a risk management group within WaMu's Home Loans Group. CW 17 explained that this development led to unqualified individuals heading various risk management functions at WaMu, and that this practice, among other practices and policies discussed below, "undermined the entire purpose of the Enterprise Risk Management initiative initiated by William Longbrake and Jim Vanasek [prior to late 2005] to adequately manage risk within the organization."

108. The detrimental effects of WaMu's new policies that began in late 2005 concerning risk management were well known to WaMu's senior management. CW 17 stated that as the Company took on higher risk activities, the risk guidelines established by his group "specifically quantified the increased level of risk that the Company was undertaking." However, according to CW 17, under the new structure implemented by Defendant Cathcart, the role of WaMu's risk management segment was supposed to be "advisory" only, and therefore warnings from Risk Management were not only discouraged, but were "very much ignored" under Defendant Cathcart's leadership.

109. Indeed, CW 17 explained that WaMu regularly compiled "Risk Reports" that "could be generated on a daily basis," and that the purpose of WaMu's Risk Reports was to verify that the Company as a whole was within guidelines ultimately established by WaMu's Board of Directors. According to CW 17, WaMu's Risk Reports were distributed "probably on a weekly basis" to all of WaMu's "C-level executives, including WaMu's President [Defendant Rotella], WaMu's Chief Risk Officer [Defendant Cathcart] and WaMu's CFO [Defendant Casey]," and were similarly provided to WaMu's Board of Directors on a quarterly basis.

110. *CW 17 explained that various Risk Reports were delivered to WaMu's senior management – including at least Defendants Rotella, Cathcart and Casey – during 2006*

1 *“specifically quantified the fact that the Company was exceeding certain risk parameters as*  
 2 *dictated by [WaMu’s] risk guidelines.”* Indeed, CW 17 stated that *“the quantitative risk metrics*  
 3 *pertaining to the loan portfolios fell out of the designated ranges on various occasions,” but*  
 4 *WaMu’s senior management – including Defendants Rotella, Casey and Cathcart – chose to*  
 5 *“simply ignore” those clear and direct warnings.*

6  
 7 111. For example, CW 17 stated that in 2006, he specifically raised with Defendants  
 8 Casey and Cathcart that the way in which WaMu’s Home Loans Group was analyzing its  
 9 subprime portfolio for risk was “just stupid,” as such analyses “specifically violated the specific  
 10 policies outlined by [WaMu’s Risk Management] group,” including disregarding the analytical  
 11 models and methods that were supposed to be utilized to conduct WaMu’s analyses of its loans.  
 12 However, when CW 17 raised these issues directly with WaMu’s senior management, his pleas  
 13 for corrective action were “simply overruled” by Defendants Casey and Cathcart. Because  
 14 his efforts to implement adequate risk controls were rebuffed by the highest level executives at  
 15 WaMu, CW 17 explained that “there was nothing that he could do about it.”

16  
 17 112. Similarly, Confidential Witness 18, a Vice President in WaMu’s Commercial Risk  
 18 Department from April 2003 until June 2006, experienced WaMu’s systematic marginalizing of  
 19 the role and authority of WaMu’s Risk Management. Before working at WaMu, CW 18 had  
 20 earned a Masters in Business Administration and possessed nearly twenty years of experience in  
 21 the banking industry, including significant experience acting as a risk management professional  
 22 at the Federal Deposit Insurance Corporation.

23  
 24 113. During his tenure at WaMu, CW 18 witnessed a Company-wide shift in focus  
 25 from strong credit management to a more “aggressive” posture toward risk. Indeed, this shift in  
 26 credit culture was mandated by executives at the highest levels of the Company. CW 18 reported  
 27

1 that in fourth quarter of 2005, several of WaMu's credit risk managers from around the country  
2 were flown by WaMu to Seattle to attend a special meeting of WaMu's credit risk management.  
3 This meeting, which was held at the Washington Mutual Leadership Center, was headed by then-  
4 Chief Enterprise Risk Officer James A. Vanasek. Vanasek informed the Company's credit risk  
5 managers that WaMu's senior management (which CW 18 understood to include the Officer  
6 Defendants) had concluded that the Company planned to be more "aggressive" in its lending and  
7 provisioning practices. According to CW 18, WaMu's risk managers were told that they were  
8 expected to cooperate with the Company's efforts to "push the envelope." Shortly after  
9 delivering news of WaMu's new policy to WaMu's senior risk managers, Vanasek – who CW 18  
10 described as WaMu's "incarnate risk management policy" while he was at WaMu – left the  
11 Company.  
12

13  
14 114. The Officer Defendants' decision to marginalize WaMu's risk management  
15 function is also documented in an internal WaMu memorandum, obtained through Lead  
16 Plaintiff's investigation, dated October 31, 2005 (the "October 31, 2005 Memo"). The October  
17 31, 2005 memo was authored by Melissa Martinez, WaMu's Chief Compliance and Risk  
18 Oversight Officer at the time, and apparently was circulated to all of WaMu's risk management  
19 personnel (including members of senior management). CW 18 recalled receiving this memo and  
20 has confirmed that the October 31, 2005 Memo was circulated to other risk managers at WaMu.  
21 CW 18 further stated that such memos were understood by WaMu's risk managers to reflect  
22 company policy that WaMu employees were required to follow.  
23

24 115. The October 31, 2005 Memo explicitly states that WaMu's risk management  
25 functions were being guided through a "cultural change" and a "behavioral change internally."  
26 *Significantly, the October 31, 2005 Memo announced that, moving forward, risk management*  
27

1 *at WaMu must occupy a “customer service”-type function, rather than impose a “regulatory*  
2 *burden” on other Company segments.* According to CW 18, the October 31, 2005 Memo was  
3 intended to signal to WaMu’s risk managers that they should “lay off” of those at WaMu who  
4 brought in revenue. Moreover, CW 18 stated that the message was heard loud and clear by  
5 WaMu’s risk managers, who felt compelled by WaMu to become less vigilant about acting to  
6 identify and control risk at the Company.  
7

8 116. As WaMu’s risk management policies shifted in response to these directives from  
9 WaMu’s senior management, CW 18 found himself increasingly disturbed by WaMu’s new,  
10 much more lenient policies concerning risk management. In particular, he was troubled by  
11 several instances in which he refused to “bend the rules” or “look the other way” at the direction  
12 of WaMu management concerning risky lending practices. CW 18 raised these issues repeatedly,  
13 but his pleas for attention were ignored, and his attempts to prevent the risky practices from  
14 occurring were countermanded by his managers. Ultimately, CW 18 even went so far as to write  
15 to Defendant Rotella in early 2006 about his serious concerns about WaMu’s increasingly lax  
16 and inappropriate risk policies. Defendant Rotella acknowledged receiving CW 18’s written  
17 concerns, but the only consequence to his whistle-blowing that CW 18 observed was that WaMu  
18 fired him in June 2006.  
19

20 117. Numerous other former WaMu employees have confirmed that the Company’s  
21 risk management infrastructure and policies significantly deteriorated beginning in the latter half  
22 of 2005, at the direction of WaMu’s senior management (including the Officer Defendants).  
23 Confidential Witness 19, former Senior Vice President, Compliance Manager, from 1997 through  
24 2007, observed that the Company’s risk management practices deteriorated significantly in late  
25 2005 as its business plan contemplated significant increases in higher-risk lending.  
26  
27

1           118. According to CW 19, James Vanasek had previously sought to create a sound risk  
2 management structure at the Company. CW 19 noted that Vanasek started to pull employees  
3 from the divisional credit and compliance areas up to a corporate or enterprise level, actions that  
4 CW 19 considered “very brave” because they were not strongly supported within the divisions or  
5 within the Company as a whole. Vanasek ultimately established and directed Enterprise Risk  
6 Management, which was responsible for providing overall corporate risk oversight over each of  
7 the different business segments. CW 19 claimed that Vanasek also had a keen interest in  
8 developing stronger home lending oversight.  
9

10           119. CW 19 attributed the decline in credit risk management to Defendant Cathcart’s  
11 assumption of the role of Chief Risk Officer. CW 19 explained that while Defendant Cathcart  
12 had previous professional experience in interest-rate risk management, he had little or no  
13 experience in overall compliance risk. According to CW 19, Defendant Cathcart had no  
14 understanding of overall compliance risk, “did not want to learn it, and generally did not care for  
15 it.” CW 19 recalled that Defendant Cathcart was very focused on analytics and essentially  
16 unwound any progress that Vanasek had made in establishing an effective compliance and credit  
17 risk function within WaMu as a whole. According to CW 19, Defendant Cathcart began to cut  
18 staff that managed compliance issues and created a large group of “analytics people” that did a  
19 lot of analysis that was “essentially irrelevant.”  
20

21           120. Specifically, CW 19 recalled weekly staff meetings with the various compliance  
22 divisions where Gregory Imm, Senior Compliance Officer from the Home Loans Group, would  
23 “be very vocal” with Defendants Cathcart and Schneider about issues within the Home Loans  
24 Group concerning compliance and credit risk deficiencies, but Defendant Cathcart did not act  
25 upon the issues presented at such meetings. Additionally, CW 19 reported that there were  
26  
27

1 weekly divisional meetings where both the senior compliance and credit risk officers would meet  
2 with the operational heads. In the case of WaMu's Home Loans segment, CW 19 explained that  
3 Defendant Schneider held weekly meetings where Imm and Mark Hillis, Senior Credit Risk  
4 Manager, would routinely report on any compliance and credit risk deficiencies. In addition,  
5 CW 19 recalled that the divisional compliance officers routinely provided reports directed to  
6 Defendant Cathcart detailing any compliance issues surfacing within the divisions. These  
7 "tracking reports" maintained an "issues log" as well as action items. CW 19 explained that each  
8 of the compliance groups performed routine sample testing of loan products to determine any  
9 compliance issues, if any, and these formed the basis of the compliance reports. CW 19  
10 summarized that, despite some of the specific issues taking place in the real estate and mortgage  
11 markets in general during the Class Period, he believes that WaMu's "current predicament" is the  
12 result of "internal issues within WaMu" that "involve the lack of risk management" and  
13 disregard for known problems, for which CW 19 attributes responsibility directly to Defendant  
14 Cathcart  
15  
16

17 121. Other witnesses confirm that WaMu deliberately restructured the Company's risk  
18 management operations to function in more of a "support role" to loan production than as an  
19 independent check against credit risk. For example, Confidential Witness 20, who was a  
20 Division Finance Officer and Senior Manager of Internal Controls with WaMu from 2002 until  
21 December 2007, reported that at WaMu, in each division, the credit risk officers reported to the  
22 President of that group. In WaMu's Home Loans segment, Credit Risk Officer Cheryl Feltgen  
23 reported directly to Defendant Schneider. Thus, according to CW 20, Defendant Schneider had  
24 extensive control over risk management within the Home Loans Group. CW 20 attributed this  
25 structure to Defendant Rotella's efforts to restructure credit risk reporting. Confidential Witness  
26  
27



1 18 similarly lamented that Defendant Rotella was charged with managing both loan production  
2 and risk management in his role as WaMu's President and COO. CW 18 explained that at most  
3 banks, credit risk officers report directly to the board of directors, rather than giving control over  
4 the Company's profits and for the Company's risk management to the same person, which  
5 presented a clear and irreconcilable conflict in CW 18's view.  
6

7 122. These hidden, risk-inducing changes took place throughout the Company's risk  
8 management structure. Confidential Witness 5, a former Vice President and Senior Credit  
9 Quality Manager, from 2005 until February 2008 and was a "Senior Credit Risk Manager" from  
10 April 2004 through March 2005. The Credit Risk program existed at WaMu only from spring of  
11 2004 through spring of 2005 during which time, CW 5's group of Credit Risk Analysts analyzed  
12 proposed exceptions to the underwriting guidelines for WaMu's more complex loans. CW 5  
13 indicated that the group reviewed all those loans that had been declined by an underwriter and  
14 other loans that were considered complex or high risk. According to CW 5, these high-risk loans  
15 included Federal Housing Administration ("FHA") loans, where the FHA guarantees loans for  
16 high-risk buyers, and first-time buyers purchasing a home under programs that provided for high  
17 LTV ratios.  
18

19 123. Importantly, CW 5 emphasized that during this timeframe, the Credit Risk  
20 Management program reported to Mark Hillis, while underwriters reported to Mark Brown.  
21 According to CW 5, the Credit Risk program was beneficial because it helped to separate the  
22 exception process on specific and discreet high-risk loans from the constant pressure on  
23 underwriters to close loans by whatever means. CW 5 further stated that members of the Credit  
24 Risk team could not be pressured as easily as underwriters and that they had the time to focus on  
25  
26  
27



1 answering why an exception could or could not be made, as opposed to being overwhelmed by  
2 the customer service mandate under which WaMu's underwriters were forced to operate.

3 124. Confidential Witness 21 observed that WaMu's risk management was markedly  
4 deficient while he was with the Company. CW 21 was a Vice President and Senior Market Risk  
5 Manager from 2005 through 2006. CW 21 reported that although WaMu was attempting in 2005  
6 to establish a presence in mortgage securitizations among the larger Wall Street banks, WaMu  
7 did not yet possess the necessary sophisticated risk management systems. CW 21 emphasized  
8 the importance of having such systems in place before embarking on high-risk lending with the  
9 goal of profiting through mortgage securitizations. CW 21 reported that more standard risk  
10 management systems maintained by other large institutions are deliberately independent. In  
11 these systems, there is a defined trade-off between risk and profit, such that clearly established  
12 limits are put in place to limit exposure or risk that a bank is willing to undertake. However,  
13 according to CW 21, at WaMu the overall risk management model was deliberately set up to be a  
14 more "cooperative" model between those who managed risk and the business units themselves  
15 whose primary concern was to generate business. According to CW 21, under the "more  
16 cooperative model" established by WaMu, risk management served a more informative, less  
17 regulatory function, such that the underlying goal was simply to "let's find a way to get things  
18 done." The trade-off at WaMu was clearly in favor of generating business.

19 125. This profits-over-risk management approach was confirmed by CW 22 a  
20 Residential Conduit Bulk Purchase Due Diligence Manager, Credit Operations Manager I, at  
21 Washington Mutual Mortgage Securities Corporation in Florence, South Carolina from January  
22 until October 2007. CW 22 conveyed that WaMu "had a culture where the role of risk  
23 management was subordinate to the objectives of the sales people," who "ran the show and  
24  
25  
26  
27

1 they're not qualified to run the show." CW 22 explained that at WaMu there was a very negative  
 2 perception of credit professionals and that, although the credit risk department was supposed to  
 3 be independent of any influences of other departments within the company, the WaMu office in  
 4 New York was "calling the shots" as to what loans were approved and not approved. CW 22  
 5 explained that at other companies' credit departments where CW 22 had worked before in CW  
 6 22's prior twelve years of experience in the mortgage industry, credit managers were allowed to  
 7 make the decisions regarding credit risk. However, at WaMu that was simply not the case. CW  
 8 22 recalled that it was very disappointing to have WaMu employees, who had no experience in  
 9 underwriting, due diligence, or credit risk, making and reversing credit decisions. At WaMu,  
 10 CW 22 observed, the salespeople were in control of the entire process and management forced  
 11 the Company's credit risk management professionals to take a subservient role to WaMu's sales  
 12 objectives.  
 13  
 14

### 15 **C. Defendants Secretly Corrupted WaMu's Appraisal Process**

16 126. During the Class Period, WaMu inappropriately, secretly, and broadly  
 17 manipulated real estate appraisals related to its home loans business. As detailed below, WaMu's  
 18 undisclosed illicit appraisal inflation practices involved, among other things:

- 19 • Direct and indirect exertion of intense pressure from WaMu  
 20 personnel – including loan production (*i.e.*, sales) personnel – on  
 21 appraisers to "hit" higher appraisal values;  
 22
- 23 • WaMu's refusal to use licensed appraisers other than those who  
 24 WaMu sales personnel hand-picked for so-called "preferred"  
 25 appraiser lists;  
 26  
 27

- WaMu policies designed to force appraisers to accede to WaMu's requests to raise appraisal values; and
- WaMu's systematic misuse of requests for reconsideration of value (so-called "ROVs") when independent appraisals did not "hit" values desired by WaMu.

These improper practices were pervasive during the Class Period.

127. As alleged in great detail herein, Defendants' hidden appraisal practices caused WaMu to originate loans that had artificially low (*i.e.*, favorable) loan-to-value (defined above as "LTV") ratios and loans that otherwise never would have been approved at all.

128. Defendants' efforts to rig the real property appraisal process relating to WaMu's loans were designed to artificially increase loan origination volume and therefore increase growth and revenue related to WaMu's core business – residential lending – and thereby make WaMu's financial condition appear healthier than it actually was.

129. In addition, WaMu's undisclosed appraisal inflation had the effect of exposing WaMu shareholders to substantial undisclosed risk, including increased credit risk. As explained in WaMu's 2006 Form 10-K: "Credit risk is the risk of loss arising from . . . the availability and quality of collateral." Thus, by misrepresenting the value of underlying loan collateral through its program of appraisal manipulation, WaMu exposed shareholders to a substantial undisclosed risk of loss from WaMu loans in WaMu's "held for investment" portfolio and to a substantial undisclosed risk on loans originated by WaMu and "held for sale" (that is, sold to third parties or securitized), due to a contingent risk of loss upon the exercise of recourse upon default of such loans or the discovered violation of the representations and warranties associated with such loans, both of which would force WaMu to repurchase such loans.

1           130. Indeed, as discussed in Section VIII, the Officer Defendants frequently referred to  
 2 purportedly low LTV ratios concerning the Company's portfolios of loans to reassure investors  
 3 that the Company was not taking on an inordinate amount of credit risk. According to Defendant  
 4 Rotella, the Company's reported LTV ratios gave the Company a "measure of protection against  
 5 losses going forward, because we do have a fair amount of cushion in those portfolios on  
 6 average."

8           131. Also, as explained in greater detail in Section VI.E, to make matters worse,  
 9 WaMu under-reserved for loan losses, at least in part, based upon misstated collateral values  
 10 resulting from its publicly undisclosed, systematic appraisal manipulation. This is because, as  
 11 stated in WaMu's 2006 Form 10-K, "[t]he estimation of the allowance [for loan and lease losses]  
 12 is based on a variety of factors, including. . . the estimated value of underlying collateral. . . ."

14           132. WaMu's shocking misconduct concerning appraisals began to come to light  
 15 publicly when the NYAG Complaint was filed on November 1, 2007. The NYAG Complaint is  
 16 available at <http://www.oag.state.ny.us/press/2007/nov/EA%20Complaint.pdf>. Although the  
 17 NYAG Complaint named only First American and eAppraiseIT as defendants, the New York  
 18 Attorney General's office made clear that: "Washington Mutual has not yet been sued [by the  
 19 New York Attorney General's office] because of questions over federal jurisdiction." *See New*  
 20 *York Widens Inquiry on Mortgages*, New York Times, November 8, 2007. In fact, on  
 21 November 7, 2007, NYAG Cuomo broadened his attack on the Company by announcing the  
 22 expansion of his investigation into WaMu's fraudulent appraisal practices to include an  
 23 examination of the loans that WaMu sold to Fannie Mae and Freddie Mac, the nation's two  
 24 biggest providers of mortgage financing. Specifically, NYAG Cuomo stated:

26                   The integrity of our mortgage system depends on independent  
 27                   appraisers. ***Washington Mutual compromised the fairness of this***

*system by illegally pressuring appraisers to provide inflated values.* Every company that buys loans from Washington Mutual must be sure that the loans they purchased are not corrupted by *this systemic fraud.*

133. The New York Attorney General office's scathing criticism of WaMu's appraisal practices arises from facts confirmed through Lead Plaintiff's investigation. As one Confidential Witness, CW 23 – a regional manager in WaMu's appraisal department from 1999 until September 2006 who then worked in a senior appraisal management position at eAppraiseIT from September 2006 until August 2007 – proclaimed, WaMu's conduct concerning appraisals was much worse than eAppraiseIT's. Indeed, the investigation undertaken on behalf of Lead Plaintiff has revealed that WaMu's secret policies and practices of inappropriate appraisal manipulation were deliberate, institutionalized, and widespread.

#### **1. The Pivotal Role of Appraisals in WaMu's Core Lending Business**

134. Appraisals are used to measure a property's estimated market value. Typically, a real estate appraisal entails both an analysis of the subject property (often including a physical inspection) as well as an analysis of market conditions, including the values of recent real estate transactions involving similar properties, commonly referred to within the industry as "comparables" or "comps."

135. Because home loans typically cannot be originated without an appraisal, a fundamental part of the home loan origination and underwriting process is the use of a valid, independent appraisal. Appraisals are typically paid for by the borrower.

136. Fair and accurate appraisals are of paramount importance to home borrowers because an appraisal that inaccurately reflects the value of a borrower's home as too high can cause that borrower to incur an amount of loan debt that is in excess of the borrower's actual needs and ability to pay and that is also unjustified by the market value of the borrower's home.

1 The result of an inflated appraisal, therefore, is significant additional risk for the borrower –  
2 including an increased risk of default on the loan (and ultimately, the borrower’s loss of the loan  
3 collateral – the borrower’s home).

4 137. Federal regulations likewise stress the importance of appraisals to WaMu and its  
5 home lending business:

6  
7 The soundness of a savings association’s mortgage loans and real estate  
8 investments, and those of its service corporation(s), depends to a great extent  
9 upon the adequacy of the loan underwriting used to support these transactions. ***An appraisal standard is one of several critical components of a sound underwriting policy because appraisal reports contain estimates of the value of collateral held or assets owned.***

10 12 C.F.R. § 564.8(a) (Emphasis in original.)

11 138. Indeed, independent appraisals were supposed to be used to determine reliable  
12 LTV ratios for loans originated by WaMu. As WaMu explained in its 2005 Amended Form 10-K,  
13 “[t]he loan-to-value ratio measures the ratio of the original loan amount to the appraised value of  
14 the collateral at origination.” Thus, the LTV ratio is directly dependent on appraisal value, and  
15 any error or fraud related to an appraisal will necessarily affect the LTV ratio. Artificially  
16 increased appraisals lead to artificially ***decreased*** LTV ratios, which make a company’s loan  
17 portfolios look less risky than they are in reality.

18  
19 139. WaMu directly and repeatedly acknowledged the paramount role of real estate  
20 appraisals to its home lending business in its public disclosures. For example, in its Amended  
21 2005 Form 10-K, WaMu emphasized the critical importance of appraisals and LTV in predicting  
22 loan performance (and therefore in measuring and controlling for risk), stating:

23  
24 The Company’s experience shows that debt-to-income ratios are less predictive of  
25 loan performance than credit scores and loan-to-value ratios, which the Company  
26 believes are the two key determinants in forecasting future loan performance.  
27

The Company and the Officer Defendants made statements to the same effect as those in the preceding paragraph throughout the Class Period (for example in WaMu's 2006 and 2007 Form 10-Ks and in quarterly financial statements throughout the Class Period).

140. WaMu also explained the following about LTV ratios in its Amended 2005 Form 10-K, and in substantially similar statements in its public filings during the Class Period:

Home loans with loan-to-value ratios of greater than 80 percent at origination without private mortgage insurance or government guarantees expose the Company to greater credit risk than home loans with loan-to-value ratios of 80 percent or less at origination.

\* \* \*

Typically, borrowers requesting financing with loan-to-value ratios of greater than 80 percent without government guarantees are required to purchase private mortgage insurance ["PMI"] from a third party. In the event of default, the Company can recover losses from the private mortgage insurer. Alternatively, under certain loan programs, qualifying customers can elect to pay a higher interest rate to the Company in lieu of paying for private mortgage insurance. This higher interest rate is expected to compensate the Company for the incremental credit risk inherent in lending to borrowers without private mortgage insurance.

Therefore, manipulations that are intended to lower LTV ratios significantly increase credit risk by allowing lenders to avoid purchasing PMI or paying a higher interest rate that would have resulted from a true, higher LTV ratio, which would have been reflected in the borrower's loan file absent the appraisal manipulation by WaMu and the Officer Defendants.

141. In addition to WaMu's and the Officer Defendants' misleading written misrepresentations concerning WaMu's LTV ratios, as set forth below in Section VIII, in earnings calls and at investor conferences, these Defendants repeatedly touted the Company's purportedly conservative LTV ratios throughout the Class Period.

142. As WaMu admitted, according to a New York Times article dated November 2, 2007, "[I]nflated appraisals are contrary to [WaMu's] interests."

1           143. While WaMu and the Officer Defendants, through their omissions and material  
 2 misrepresentations, created the misleading impression that WaMu's loans were sound and the  
 3 product of fair, reliable and independent appraisals (and, that, therefore WaMu's credit quality  
 4 was good), as set forth in Section VIII, and as alleged in detail below it is clear that Defendants'  
 5 statements were materially false and misleading when made in light of the facts known to or  
 6 recklessly disregarded by Defendants.  
 7

8                           **2. Appraisals Relating to WaMu Loans**  
 9                           **Were Governed by Strict Rules Designed**  
 10                           **to Maintain Appraisal Integrity and**  
 11                           **Accuracy**

12           144. WaMu is regulated by, among other agencies, the OTS, and must comply with  
 13 rules, guidelines and procedures designed to protect the integrity of the lending process, and in  
 14 particular, appraisals. *See, e.g.*, 12 C.F.R. § 564 et seq.

15           145. At all times during the Class Period, Title 12 of the United States Code of Federal  
 16 Regulations set forth regulations and standards pertaining to real estate appraisals. WaMu's  
 17 lending activities that required appraisal services constituted "regulated transactions," which are  
 18 defined to include real-estate related financial transactions involving any OTS-regulated  
 19 institution. 12 C.F.R. § 564.2.

20                           **a. WaMu's Appraisals Were Required to Be**  
 21                           **Fair, Accurate, and Unbiased**

22           146. According to federal regulations in effect throughout the Class Period (and  
 23 through the present time), an appraisal must be "a written statement *independently and*  
 24 *impartially* prepared by a qualified appraiser setting forth an opinion as to the market value of an  
 25 adequately described property as of a specific date(s), supported by the presentation and analysis  
 26 of relevant market information." 12 C.F.R § 564.2.  
 27



1 147. Moreover, under the minimum appraisal standards set forth in 12 C.F.R. §564.4,  
 2 all appraisals in regulated transactions must conform with Uniform Standards of Professional  
 3 Appraisal Practice (“USPAP”) unless other principles require stricter standards.

4 148. USPAP is issued by the Appraisal Foundation, a private nonprofit organization.  
 5 USPAP guides the conduct of both appraisers and their customers, and reflects the minimum  
 6 industry standard for providers and consumers of appraisals. USPAP is intended to promote a  
 7 high level of public trust in the appraisal practice by ensuring that appraisal services are  
 8 meaningful, accurate and not misleading. Moreover, USPAP guidelines emphasize that *the*  
 9 *objectives of the client must never affect the appraiser’s independence or objectivity.* See  
 10 USPAP, Statement on Appraisal Standards No. 9 (SMT-9) (2005), available at  
 11 <http://www.coylelynch.com/USPAP%202005.pdf>.  
 12

13 149. Prior to hiring eAppraiseIT and LSI to conduct appraisals on its behalf, WaMu  
 14 maintained its own department of in-house staff appraisers. Provisions in the Code of Federal  
 15 Regulations that regulated WaMu’s conduct in its capacity as a participant in such federally-  
 16 regulated transactions state, among other things, that an in-house or “staff” appraiser at a lending  
 17 institution “*must be independent of the lending, investment, and collection functions. . .*” 12  
 18 C.F.R. § 564.5(a).  
 19

20  
 21 **b. Federal Regulations Required that**  
 22 **WaMu’s Directors and Senior Officers**  
 23 **“Develop, Implement, And Maintain”**  
 24 **Appropriate Appraisal Policies for WaMu**

25 150. In recognition of the dependence of the “soundness of [WaMu’s] mortgage loans  
 26 and real estate investments” on WaMu’s appraisals, WaMu’s directors and officers were required  
 27 to “develop, implement, and maintain appraisal policies to ensure that appraisals reflect  
 28

professional competence and to facilitate the reporting of estimates of market value upon which savings associations may rely to make lending decisions.” 12 C.F.R. 564.8.

151. Specifically, federal regulations applicable to WaMu throughout the Class Period required the Officer Defendants (among other senior executive and directors) to:

- *Develop written appraisal policies*, subject to formal adoption by WaMu’s board of directors, *to “ensure that adequate appraisals are obtained and proper appraisal procedures are followed consistent with the requirements of [federal regulations]”*;
- *Develop and adopt guidelines and institute procedures pertaining to the hiring of appraisers to perform appraisal services for WaMu consistent with the requirements of federal regulations.* Such guidelines were to “set forth specific factors to be considered by management” in connection with hiring appraisers to perform services for WaMu; and
- *“[R]eview on an annual basis the performance of all approved appraisers used within the preceding 12-month period for compliance* with (i) the savings association’s appraisal policies and procedures; and (ii) the reasonableness of the value estimates reported.”

12 C.F.R. § 564.8(c).

c. **Defendants Were Specifically Advised of Governing Appraisal Standards and Were Instructed by WaMu's Regulators to Take Appropriate Actions to Meet Those Standards**

152. In addition to the governing rules and regulations discussed above, on March 22, 2005, federal regulators – including the OTS, which regulates WaMu – published guidance directly applicable to WaMu on appraisals, entitled “Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions” (the “2005 Interagency Appraisal Guidelines”).

153. In fact, according to documents posted on the OTS website, on March 22, 2005, OTS sent a letter to the Chief Executive Officers of the institutions that it regulated, including WaMu, enclosing the 2005 Interagency Appraisal Guidelines (the “2005 OTS Cover Letter”). A true and correct copy of the 2005 OTS Cover Letter and the accompanying 2005 Interagency Appraisal Guidelines are attached hereto as Appendix 4 and are also available online at: <http://www.ots.treas.gov/docs/2/25213.pdf>.

154. Therefore, Defendant Killinger personally received, and should have reviewed, a copy of the 2005 OTS Cover Letter and the 2005 Interagency Appraisal Guidelines.

155. The 2005 OTS Cover Letter sent to Defendant Killinger instructed, in relevant part, as follows:

***Savings associations' board of directors and management should review the [2005 Interagency Appraisal Guidelines] in conjunction with the OTS appraisal regulations, the Interagency Appraisal and Evaluation Guidelines (October 1994), and the Interagency Statement on Independent Appraisal and Evaluation Functions (October 2003). Internal policies and procedures should ensure that, among other considerations, the savings association's appraisal and evaluation function is safeguarded from internal influence and interference from the loan production staff.***

1           156. Therefore, (and for the additional reasons discussed herein), WaMu and the  
2 Officer Defendants, among other WaMu senior executives and directors, were on notice of their  
3 obligations to ensure that WaMu was conducting fair and accurate appraisals. In fact, as set forth  
4 below, WaMu and the Officer Defendants were given detailed instructions about how the  
5 Company's appraisal process should work and who was permitted to be involved in that process.  
6

7           157. Specifically, the 2005 Interagency Appraisal Guidelines "apply to all real-estate-  
8 related financial transactions regardless of size or whether loans are for a regulated institution's  
9 own portfolio, held for sale, or held in asset-backed conduits." Furthermore, the 2005  
10 Interagency Appraisal Guidelines mandate, among other things, that:

- 11           • *Loan production staff should not select appraisers.* (Loan  
12 production staff "consists of those responsible for generating loan  
13 volume or approving loans, as well as their subordinates. This  
14 would include any employee whose compensation is based on loan  
15 volume.")
- 16           • *Loan production staff should not be involved in developing or*  
17 *maintaining lists of appraisers*, and that any such list of appraisers  
18 should be the subject of periodic evaluation to maintain  
19 independence.  
20
- 21           • *Upon engaging an appraisal, "information provided by the*  
22 *regulated institution should not unduly influence the appraiser*  
23 *or in any way suggest the property's value."*  
24  
25  
26  
27

- Prior to making a final credit decision, *“regulated institutions should perform a compliance review on all appraisals to confirm that they comply with the minimum appraisal standards. . . .”*

158. Moreover, the Interagency Statement on Independent Appraisal and Evaluation Functions (October 2003) that is directly referenced in 2005 Interagency Appraisal Guidelines, in a section entitled “Appraisal and Evaluation Compliance Reviews,” warns that:

An institution’s appraisal and evaluation program must maintain effective internal controls that promote compliance with program standards and the agencies’ appraisal regulations and Guidelines. Internal controls should, among other criteria, confirm that appraisals and evaluations are reviewed by qualified and adequately trained individuals *who are not involved in the loan production processes.*

159. Similarly, the Interagency Appraisal and Evaluation Guidelines (October 1994) that are specifically referenced in the 2005 OTS Cover Letter, state in a section titled “Independence of the Appraisal and Evaluation Function,” that: “Because the appraisal and evaluation process is an integral component of the credit underwriting process, it should be isolated from influence by the institution’s loan production process.”

160. The guidelines and principals described above were unambiguous and fundamental to WaMu’s core business of residential lending. Yet, as alleged in detail below, WaMu systematically violated or circumvented each of these clear requirements and instead took inappropriate steps to influence and inflate appraisals.

### 3. Defendants Secretly Caused Appraisals Relating to WaMu Loans to be Improperly Inflated

161. At the start of the Class Period through mid-2006, WaMu generally utilized in-house appraisers to perform appraisals on properties for which WaMu originated loans. WaMu’s in-house appraisal functions raised concern from federal regulators because, as apparent from the

1 2005 Interagency Appraisal Guidelines discussed above, banks and other lending institutions that  
2 both originated and issued appraisals for the same loans faced potential conflicts of interest  
3 concerning appraisal values.

4 162. As discussed below, this concern was particularly warranted with respect to  
5 WaMu, as the Officer Defendants' policies caused appraisal values generated by WaMu's in-  
6 house appraisers to be artificially inflated. Indeed, evidence, including statements from several  
7 witnesses with direct knowledge of WaMu's in-house appraisal practices, confirms that WaMu  
8 systematically manipulated the appraisal process to increase appraisal values from at least the  
9 start of the Class Period until WaMu outsourced its appraisals to supposedly-independent  
10 appraisal companies in the Summer of 2006.

11 163. Starting in July 2006, WaMu outsourced the vast majority of its residential  
12 lending appraisal work to two purportedly-independent appraisal companies, eAppraiseIT and  
13 LSI. Ostensibly, these companies were to protect the integrity of the appraisal process and  
14 eliminate the avenues that had previously existed to inflate appraisal values when appraisals  
15 were conducted "in-house" at WaMu.

16 164. The appraisal process WaMu began in July 2006 appeared outwardly to function  
17 as follows: Either eAppraiseIT or LSI would receive an appraisal order from WaMu.  
18 eAppraiseIT or LSI would then independently select an independent appraiser, provide the  
19 necessary information to the appraiser, and then, once the appraisal was complete, report the  
20 impartial results to WaMu. However, from the very initiation of outsourcing its appraisal work,  
21 WaMu corrupted the appraisal process by persisting in practices designed to increase appraisal  
22 values whenever necessary to produce more WaMu loans. Indeed, as described below, along  
23 with other practices designed to increase appraisal values, WaMu required that eAppraiseIT and  
24  
25  
26  
27

1 LSI use only appraisers for WaMu loans from a pre-selected, limited list that was created and  
2 continually vetted by WaMu sales personnel (*e.g.*, WaMu loan consultants and brokers and their  
3 managers). As noted above, eAppraiseIT alone performed at least 260,000 appraisals for WaMu  
4 at a cost of \$50 million during the Class Period.

5  
6 165. Throughout the Class Period, WaMu, in direct contradiction of the regulations and  
7 guidelines discussed above, secretly and systematically exerted pressure on appraisers to increase  
8 appraisal values for the purpose of “hitting” values unsupported by the true market value of the  
9 real estate collateral in question. These practices included improper contact and pressure from  
10 WaMu loan production (*i.e.*, sales) personnel directed at appraisers to “hit” the higher appraisal  
11 values that WaMu and its loan production team desired, the widespread use of unjustified  
12 requests for reconsideration of value (“ROVs”), policies designed to encourage appraisers to  
13 accede to WaMu’s requests to raise appraisal values, and WaMu’s refusal to work with licensed  
14 appraisers other than those who *WaMu loan production staff hand-picked* for so-called  
15 “preferred” appraiser lists.  
16

17 166. As confirmed by evidence provided by numerous former employees of WaMu,  
18 eAppraiseIT, and LSI and other sources of information detailed below, with the knowledge or  
19 reckless disregard of the Officer Defendants, in-house appraisers at WaMu, and later appraisers  
20 obtained by WaMu through eAppraiseIT and LSI, were routinely and improperly caused to  
21 inflate appraisal values in furtherance of Defendants’ goal of increasing loan volume to inflate  
22 the Company’s earnings.  
23  
24  
25  
26  
27

**a. Numerous WaMu-affiliated Persons  
Witnessed WaMu's Systematic  
Manipulation of the Appraisal Process**

167. Percipient witnesses who were affiliated with WaMu have explained in great detail the corrupt appraisal patterns and procedures used by WaMu with the Officer Defendants' knowledge or reckless disregard.

168. CW 24 worked for WaMu for 5 years, during the last 4 years of which, from 2002 until October 2006 (approximately four months after the Company had outsourced the majority of its appraisal work to eAppraiseIT and LSI), CW 24 was a Senior Appraisal Coordinator. As a Senior Appraisal Coordinator, CW 24 served as a liaison between WaMu loan officer/brokers (*i.e.*, loan production staff) and WaMu appraisers and was responsible for, among other things, helping to originate residential loans for the Southeastern United States.

169. CW 24 explained that, from 2005 through October 2006, WaMu significantly increased pressure to exaggerate appraisal values. Indeed, CW 24 stated that the push by WaMu to inflate appraisals was a constant problem throughout the Class Period: both in-house and outside appraisers working for WaMu regularly complained to CW 24 about WaMu requiring "a certain value" to make loans "work." As explained by CW 24, appraisal inflation occurred through the widespread use of ROVs on appraisals that had been completed and by loan production staff regularly influencing appraisers through direct contact intended to pressure them.

170. According to CW 24, "ROVs were done constantly" by WaMu to try to increase appraisal values during the Class Period. In fact, CW 24 stated that, when comparing an equal number of loans that were processed in CW 24's WaMu offices, the number of ROVs for WaMu in-house appraisals doubled or tripled during in the Class Period compared with ROVs requested



1 prior to the Class Period, from 2002 through 2004. As a result, CW 24 explained that WaMu  
2 assigned additional staff to deal with the increasing ROVs. Moreover, CW 24 stated that, around  
3 80% of the time when a ROV was requested by WaMu, the appraisal value was increased.

4 171. CW 24 stated that when WaMu began to outsource its appraisals to eAppraiseIT  
5 and LSI, the amount of ROVs requested by WaMu loan production increased by at least three or  
6 four times the levels experienced before the start of the Class Period. CW 24 attributed this  
7 sharp increase to the fact that WaMu was not initially able to “wheel and deal” quite as easily  
8 with outside appraisals staff as it had with its in-house appraisers, and therefore sometimes had  
9 to use the appearance of more formal channels to influence appraisers to inflate value.  
10

11 172. Also throughout the Class Period, CW 24 stated that when she called appraisers in  
12 the normal course of business, the appraisers she contacted very frequently complained about  
13 being pressured by WaMu production personnel (loan officers or brokers) to use more comps or  
14 find other ways to increase appraisal values. This happened despite that fact that, as CW 24  
15 stated and as dictated by relevant regulations and guidelines, it was unlawful for loan production  
16 staff to contact appraisers directly.  
17

18 173. Overall, CW 24 reported that, from 2002 to 2006, WaMu’s practice was to inflate  
19 appraisal values whenever possible using the methods described above and, when those avenues  
20 were unavailable for any reason, to find other ways to increase appraisal values in furtherance of  
21 the Officer Defendants’ goal of closing more loans. As CW 24 stated, if WaMu “could find a  
22 loophole to make the value work, they would do it.”  
23

24 174. Similarly, CW 25, a loan consultant at WaMu Home Loans in Maryland from  
25 September 2003 until November 2005, described the appraisal process at WaMu as “corrupt” and  
26 “dysfunctional.” Specifically, CW 25 stated that, during his time at the Company, even through  
27

1 the appraisal process was handled internally through loan coordinators, the loan officer who  
2 brought in the loan was typically able to request a specific appraiser. CW 25 also explained that  
3 in the event that a loan officer was provided an appraisal value that the loan officer deemed  
4 unsuitable, that loan officer could and would request an ROV. Indeed, CW 25 stated that WaMu  
5 loan officers regularly put a great deal of pressure on the loan coordinators and demanded that  
6 initial appraisal values be reevaluated if unacceptable to them  
7

8 175. Overall, CW 25 stated that the appraisal process at WaMu was “dysfunctional.”  
9 CW 25 reported that appraisers received kickbacks from loan consultants to “hit” value on  
10 appraisals. CW 25 said that he complained to management that the appraisal process at WaMu  
11 was corrupt, but that nothing was changed, and his job was threatened on many occasions in  
12 response to his complaints of appraisal corruption.  
13

14 176. CW 26 was a Loan Coordinator with the Freedom Crossing Trail (Jacksonville,  
15 FL) WaMu offices from July 2005 through September 2007. In that capacity, CW 26 was  
16 responsible for processing loan paperwork and ordering appraisals, including through  
17 eAppraiseIT and LSI, related to WaMu loans. CW 26 stated that management was always “on  
18 top of” loan coordinators such as [herself] to “make loans go through,” and specifically that the  
19 pressure from management caused *WaMu loan consultants* to “work with appraisers to try to  
20 make loans go through.” This activity was improper under the relevant standards for appraisals,  
21 including the 2005 Interagency Appraisal Guidelines.  
22

23 177. In response to the pressure from management, CW 26 stated that if, for example, a  
24 first appraisal resulted in an LTV ratio above 80%, WaMu loan consultants would try to get an  
25 appraiser to increase the appraisal value to reduce the LTV ratio below 80% by increasing the  
26 appraisal value. CW 26 explained that this unjustified increase would obviate the need for the  
27

1 borrower to purchase private mortgage insurance, and would therefore increase the overall  
2 likelihood of WaMu closing such loans. As explained above, this practice served to create a  
3 hidden increase of credit risk for such loans.

4 178. CW 9 was a Senior Loan Coordinator for WaMu's Home Loan Center in Bethel  
5 Park, Pennsylvania from February 1998 until September 2007. As a senior loan coordinator, CW  
6 9 "processed the loans from beginning to end, and dealt with attorneys, title companies,  
7 customers, loan officers, and realtors." CW 9's office processed loans from all over the United  
8 States and focused on New York, New Jersey and Connecticut.

10 179. CW 9 stated that during the Class Period, everyone in her office was  
11 experiencing intense pressure from WaMu management to close loans. CW 9 stated that loan  
12 coordinators such as herself received bonuses based on the amount of loans they closed.  
13 Apparently, this was not enough of an enticement to close as many loans as the Officer  
14 Defendants desired, as CW 9 explained that once a week she and others would be called into  
15 meetings with more senior managers and would be grilled on the details of any loans that did not  
16 close. According to CW 9, this pressure "was coming from the very top, the managers had to  
17 listen to the head manager, who had to listen to corporate." CW 9 added that the pressure in the  
18 Company to close loans was so intense, it almost caused her to have a "nervous breakdown."

20 180. CW 9 explained that until late 2006, WaMu had "a team who did [the appraisals],  
21 but the Company "phased that away late 2006/early 2007" and, as a result, "laid off a lot of  
22 people." After WaMu outsourced the bulk of its appraisal services, there were "only a couple of  
23 people" handling appraisals at WaMu in what was called the Appraisal Resource Center  
24 ("ARC").  
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1 181. CW 9 observed that, beginning around September 2006, “loan officers were  
2 submitting more ROVs” and that loan and appraisal values were higher than they had been. CW  
3 9 stated that during this time, “the loans and the values were all high – I just thought that ‘maybe  
4 this is the way things are done now.’”

5 182. CW 10 was a Loan Coordinator/Mortgage Processor for WaMu in Jacksonville,  
6 Florida from March 2007 until she was laid off in December 2007. As a loan coordinator, CW  
7 10 processed mortgage loan application, including gathering the necessary loan documents from  
8 customers, ordering appraisals, and then sending the files to underwriting.

9 183. CW 10 said that everyone at WaMu was under constant pressure from upper  
10 management to “hit numbers.” That pressure to “push, push, push” was widely understood to  
11 mean that WaMu employees needed to do “whatever it took to get loans closed,” according to  
12 CW 10.  
13

14 184. According to CW 10, appraisals were ordered through WaMu’s OptisValue  
15 system. When CW 10 ordered an appraisal, CW 10 would include an estimated value of how  
16 much the home in question was “worth,” which was available from WaMu information systems.  
17 At times, CW 10’s managers, who knew the appraisal values that would be needed to close  
18 particular loans, would direct CW 10 to include proposed appraisal values to transmit along with  
19 the appraisal order to the appraisers. After WaMu’s proposed appraisal values were included  
20 with the appraisal orders, CW 10 stated, the appraisal work would be assigned to an appraiser  
21 through eAppraiseIT or LSI.  
22

23 185. CW 10 remarked that sometimes the value needed for WaMu loans to close  
24 “would be there and sometimes it wasn’t.” CW 10 estimated that 90% of the time, CW 10 would  
25 need to submit an ROV along with some additional information – like added comps or “anything  
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27

1 to try to help to get the value you needed it to be.” According to CW 10, the appraisal value  
2 would be *increased* after an ROV request.

3 186. CW 10 felt that, overall, WaMu loan appraisal values were inflated. CW 10 is  
4 aware that senior managers in her WaMu branch had meetings with eAppraiseIT and LSI two or  
5 three times during CW 10’s tenure with the Company. WaMu employees understood that these  
6 managers wanted to meet with the outside appraisers because, according to CW 10, as far as  
7 WaMu was concerned the outside “appraisals were coming out too low.” WaMu also wanted a  
8 quicker turnaround time from the appraisers. CW 10 believes that there were meetings of this  
9 sort at least in June or July of 2007, and again in October 2007. One of CW 10’s managers, Kim  
10 Ivey, reported on these meetings during morning or afternoon “huddles.” Ivey told CW 10 and  
11 other WaMu employees that *WaMu management had met with eAppraiseIT and LSI to demand*  
12 *less resistance against WaMu’s efforts to obtain higher appraisal values and that eAppraiseIT*  
13 *and LSI were going to “do everything possible within reason to accommodate [WaMu’s] needs*  
14 *in terms of the appraised values.”*

15 187. CW 27 began his career as an appraiser in 1990 at a bank WaMu bought in 1997,  
16 after which CW 27 worked as a staff and production appraiser for WaMu from 1997 to 1999.  
17 Thereafter, CW 27 continued to handle WaMu appraisals as an independent contractor. When  
18 WaMu started outsourcing appraisals in the summer of 2006, CW 27 continued to perform  
19 WaMu appraisals as an approved appraiser with eAppraiseIT, as he had already been on a WaMu  
20 “approved appraiser” list. CW 27 conducted appraisals on behalf of WaMu through LSI as well.

21 188. Even though CW 27 was “approved” on a list created by WaMu, CW 27 felt that  
22 there should have been no need for such approved appraiser lists, because all appraisers are  
23 licensed.  
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1 189. CW 27 reported that while conducting appraisals on behalf of WaMu through  
2 eAppraiseIT, he was often contacted directly by WaMu brokers and loan officers (*i.e.*, loan  
3 production staff).

4 190. CW 27 explained that if he did not increase appraisal value in response to an ROV  
5 from WaMu, WaMu required CW 27 to provide detailed explanations about why he *did not*  
6 change the value. CW 27 stated that, for example, if he had been provided with six or seven new  
7 comps with a WaMu ROV, he was required to comment on each of them, explaining why he  
8 would not use each comp. In contrast, no explanations were necessary when the initial appraisal  
9 value was changed in response to a ROV. In addition, even after CW 27 refused to increase the  
10 appraisal value in response to an ROV, WaMu would sometimes send another ROV with even  
11 more comps and, on several occasions, WaMu sent multiple ROVs on the same appraisal. CW  
12 27 stated that it was his experience that the comps WaMu offered with the ROVs were irrelevant,  
13 either because they were too old or were outside of the subject property's area. CW 27 said that  
14 most of the time the ROVs WaMu submitted were ridiculous, a waste of time and "a bunch of  
15 baloney."  
16

17 191. CW 28 was an Appraisal Field Manager for WaMu in Columbia, MD from  
18 November 2003 until September 12, 2006. CW 28 was part of a three person management team  
19 responsible for the management of appraisal-related services for WaMu's retail and wholesale  
20 lending in Maryland, Virginia and the District of Columbia. CW 28 hired internal appraisers for  
21 WaMu and oversaw the review of appraisals of loans through WaMu's wholesale channel.  
22

23 192. CW 28 would mediate appraisal issues and valuation disputes raised by the sales  
24 staff. CW 28 stated that there were "daily struggles" to try to keep the line drawn between the  
25 sales staff's "objectives" and those of the appraisers. During the Class Period, according to CW  
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28, the scale was clearly tipped in favor of loan production at WaMu and closing loans, as “sales staff had a lot of clout” in these “constant battles” concerning appraisals and value.

193. Often, CW 28 noted, the sales staff would submit ROVs. According to CW 28 sometimes loan production had “something they could offer [WaMu’s in-house appraisers]” in connection with an ROV, but other times the ROV would be submitted without any additional information supporting an increase in appraisal value. CW 28 noted that WaMu personnel at his level could make changes to an appraisal report directly in WaMu’s system and remarked that the system itself was flawed.

194. Confidential Witness 29 worked as an Underwriter with WaMu from 2002 through 2006 in Portland, Oregon, with one of WaMu’s highest-producing teams in Oregon. In that capacity, CW 29 “saw a lot of loan volume” and also “saw a lot of things that weren’t right.” As an underwriter, CW 29 recalled “seeing numerous questionable appraisals for WaMu’s loans.” However, CW 29 stated that WaMu supervisors would “get upset with underwriters for looking at the appraisals” and “independently raising any issues with the appraisal values.” As a result, CW 29 explained, “if a loan application did not already note that there was a problem with the appraisal value, then underwriters were not supposed to acknowledge it.” Rather, underwriters were told “do not look at that – the appraiser said it was okay.” As a result, CW 29 reported that, “across the board,” appraisal values were high at WaMu. CW 29 stated that, “We were amazed as underwriters.”

195. In addition to being reprimanded for bringing appraisal problems to the attention of WaMu management, CW 29’s supervisors also repeatedly dismissed CW 29’s unease related to other issues bearing on borrowers’ credit-worthiness. As set forth in detail in Section VI.D,

below, “rather than hearing out” CW 29’s and other underwriter’s concerns, WaMu management “always backed the loan officers.”

196. Although WaMu’s LBM loans typically were not originated with appraisals sourced by WaMu or LBM, but instead arrived with an appraisal accompanying the loan documents provided by the mortgage broker who initiated an LBM loan, even LBM employees were familiar with the widespread appraisal inflation practices of their colleagues at WaMu. For example, CW 30, an account executive at LBM from 2004 through November 2007, stated that WaMu was “definitely aggressive with appraisals” and that WaMu therefore “seemed to get a lot of values.” Indeed, CW 30 stated that such inflation was a “running joke” within the mortgage broker community.

**b. Numerous eAppraiseIT-affiliated Persons  
Witnessed WaMu’s Systematic  
Manipulation of the Appraisal Process**

197. Percipient witnesses who were affiliated primarily with eAppraiseIT during the period in question have also explained in great detail the corrupt appraisal patterns and procedures used by WaMu with the Officer Defendants’ knowledge or reckless disregard.

198. CW 31 was recruited by WaMu as a staff appraiser in June 2003. In February 2004, the Company laid off CW 31. However, WaMu assured CW 31 that it would be “business as usual,” with the only difference being that CW 31 would now do his appraisal work as a contractor for WaMu and that CW 31 would make more money doing so.

199. CW 31 stated that WaMu laid off its appraisal staff in several rounds over the several of years beginning in 2004. For example, CW 31 explained that a number of experienced employees were laid off in February 2004 along with CW 31. CW 31 indicated that WaMu simply turned the former WaMu staff appraisers into contract appraisers through eAppraiseIT



1 and LSI. CW 31 was one of the first people to become a WaMu “preferred appraiser” at  
2 eAppraiseIT, starting immediately after his layoff. CW 31 also began contracting with LSI a  
3 couple of months later. While eAppraiseIT only gave CW 31 WaMu assignments, LSI provided  
4 CW 31 with work from WaMu and other banks. CW 31 reported that he performed “at least  
5 twenty appraisals per month” on behalf of WaMu from 2004 through November 2007, when  
6 WaMu ceased ordering appraisals through eAppraiseIT.  
7

8 200. CW 31 reported to CW 23, an Appraisal Manager at both WaMu and eAppraiseIT.  
9 CW 23 was employed as a manager at WaMu until WaMu laid him off in September 2006 in  
10 connection with the Company’s outsourcing of its appraisal business, after which he went to  
11 work for eAppraiseIT. According to CW 31, this was a significant conflict of interest because  
12 CW 23 essentially retained the same authority CW 23 had at WaMu and continued to decide  
13 which appraisers should perform WaMu’s work. As CW 31 explained, when CW 23 “went to  
14 eAppraiseIT, he took his ‘black book’ with him and he brought all of the appraisers that used to  
15 work for him at WaMu on as ‘preferred appraisers.’” According to CW 31, other WaMu  
16 managers also became management at eAppraiseIT after WaMu’s layoffs.  
17

18 201. CW 31 stated that for WaMu, “*it was all about LTV,*” and therefore WaMu  
19 dictated appraisal values that it needed to satisfy the LTV ratios it desired – typically, LTV values  
20 below 80%. CW 31 specifically explained that if WaMu needed an 80% LTV, and the borrower  
21 needed a \$364,000 loan, then WaMu required an appraisal reflecting a value of at least \$455,000,  
22 irrespective of the market value of the real estate in question.  
23

24 202. CW 31 explained that *WaMu had a practice of noting the value it wanted for a*  
25 *home on its initial appraisal request.* CW 31 explained that, for instance, a WaMu appraisal  
26 order would arrive with WaMu’s estimated value for the collateral of \$455,000. CW 31 further  
27

1 explained that under such circumstances, if the appraiser valued the property at an amount lower  
2 than WaMu's estimated value, then the appraiser would receive an ROV request. CW 31 stated  
3 that a significant number of eAppraiseIT appraisers "were simply coming in at the estimated  
4 value to avoid getting an ROV."

5  
6 203. Regarding ROVs, CW 31 explained that if he did not agree to the appraisal value  
7 WaMu wanted, WaMu would send a ROV form to him. CW 31 would then have to review the  
8 appraisal and "see if he was able to change the value." CW 31 noted that sometimes WaMu  
9 would provide him with new information about the home in question, such as additional comps  
10 or information about purported upgrades on the home in question. CW 31 further explained that  
11 if he did not increase the appraisal value in response to an ROV, WaMu would require him to  
12 provide additional information and do extra work to defend his original value. CW 31 stated that  
13 because of WaMu's onerous policy, many appraisers would simply increase value rather than  
14 deal with the additional work. Moreover, when CW 31 refused to increase the appraisal value  
15 for WaMu, he often received a phone call from WaMu or CW 23 indicating that the ROV request  
16 had been escalated. Indeed, CW 31 reported that *if a WaMu loan officer complained strongly*  
17 *about an appraiser not cooperating with the Company, the appraisers knew that they would*  
18 *not receive further work from WaMu.*  
19

20  
21 204. According to CW 31, although WaMu loan officers were not supposed to contact  
22 appraisers directly, they nonetheless would frequently call or email eAppraiseIT appraisers after  
23 receiving a copy of an appraisal. CW 31 explained that WaMu loan officers contacted CW 31  
24 frequently about appraisal values. Specifically, CW 31 explained that if WaMu did not believe  
25 that an appraised value was high enough for a loan to go through, CW 31 would get a call from  
26 either an employee at eAppraiseIT or sometimes the WaMu loan officer, asking if CW 31 "could  
27

1 help them out with value.” Occasionally, CW 31 stated, CW 23 would call to ask CW 31 to look  
2 at an appraisal again or CW 23 would provide CW 31 with additional information related to an  
3 appraisal.

4 205. CW 31 explains that he lost business because he was “trying to do the right  
5 thing.” Specifically, CW 31 stated that WaMu curtailed CW 31’s workload because CW 31  
6 refused to “change value” on several appraisals. CW 31 explained that one central unspoken rule  
7 – that WaMu would cut an appraiser out of WaMu’s preferred list if he did not increase appraisal  
8 values – was crystal clear to appraisers: “when an appraiser’s business was cut off, you knew it  
9 was because you were not playing their game.” CW 31 stated that, for example, WaMu would  
10 request a change in value if the true market value of a home reflected in an appraisal “came in”  
11 at \$500,000, but WaMu needed \$525,000 for its loan to close. CW 31 gave an example of an  
12 appraisal for a property that CW 31 refused to change the value on for WaMu in February 2007,  
13 which he believes resulted in WaMu punishing him by reducing his workload. CW 31 recalled  
14 that the property in question was in Santa Ana, CA, and was worth close to \$1 million. CW 31  
15 stated that WaMu wanted the appraisal value increased by at least \$100,000, but likely closer to  
16 \$400,000. Despite WaMu’s repeated requests, CW 31 refused to change the appraisal value  
17 because he looked at the appraisal and did additional research and was therefore certain that the  
18 initial appraisal was correct. As a result of his refusal, WaMu started to reduce CW 31’s  
19 workload.  
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23 206. According to CW 31, around May or June of 2007, eAppraiseIT “got nervous and  
24 sent out blanket emails to appraisers saying ‘Please contact us if a loan officer ever contacts you;  
25 they are not allowed to contact you,’ but the damage was already done.” CW 31 believed that  
26 eAppraiseIT started sending such emails to “cover their tracks” in the face of the New York  
27

1 Attorney General's office's investigation. CW 31 stated, however, that such emails "came out  
2 too late, because the loans with inflated appraisal values had already gone through."

3 207. CW 23 worked as a Regional Manager in WaMu's Appraisal Department from  
4 1999 until September 2006. In September 2006, CW 23 went to work for eAppraiseIT and  
5 stayed there until August 2007. At eAppraiseIT, CW 23 was the Area Manager for Southern  
6 California and reported to Peter Gailitis, eAppraiseIT's nationwide Chief Appraiser. CW 23  
7 noted that in addition to him, eAppraiseIT hired six appraisal managers from WaMu.  
8

9 208. As set forth below, based on his first-hand experiences and knowledge, CW 23  
10 believes "that the [New York Attorney General's] suit is backwards" because WaMu's appraisal  
11 practices were improper and largely responsible for the misconduct alleged in the NYAG  
12 Complaint. Indeed, CW 23 observed significant problems created by WaMu in connection with  
13 the appraisals that it outsourced. As explained below, CW 23 indicated that WaMu's senior  
14 management was aware of WaMu's dubious practices, and in many cases directed them. CW  
15 23's experiences with WaMu while at eAppraiseIT evidence WaMu's desire to subvert  
16 appropriate appraisal standards and processes in favor of increasing loan originations. As CW 23  
17 put it, "*The Sales Department has a voice in Washington Mutual because they generate the*  
18 *income – the Sales Department drove Washington Mutual.*" Moreover, CW 23 felt that there  
19 was an "obvious disconnect" between what WaMu senior management was saying publicly  
20 about appraisals and what the Company was doing "in the field." Prior to outsourcing, CW 23  
21 maintained that many of the same undisclosed problems existed, although the practices escalated  
22 in degree, if not kind, once WaMu outsourced its appraisals.  
23  
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25 209. CW 23 explained that his first six months after he began working with  
26 eAppraiseIT were "full of turmoil" for many reasons. In particular, CW 23 pointed to WaMu's  
27

1 insistence on using appraisers from a “preferred” list chosen predominately by WaMu’s loan  
2 sales personnel.

3 210. According to CW 23, during the initiation of WaMu’s outsourcing, WaMu  
4 informed eAppraiseIT that eAppraiseIT had to use WaMu’s panel of appraisers. According to  
5 CW 23, the appraiser panel became a source of contention between the two companies. CW 23  
6 recounted that eAppraiseIT initially opposed WaMu dictating which appraisers eAppraiseIT  
7 could assign, but WaMu stood firm, insisting that eAppraiseIT use WaMu’s selected appraisers.  
8 According to CW 23, the list of appraisers who could handle WaMu appraisals was ultimately  
9 called the “preferred list,” but the name changed several times. According to CW 23,  
10 eAppraiseIT and LSI received the same preferred appraiser lists from WaMu.  
11

12 211. CW 23 explained that eAppraiseIT was concerned about many aspects of WaMu’s  
13 “preferred” list of appraisers, including the list’s very name. CW 23 stated that eAppraiseIT  
14 worried about the perceptions of “preferred” over regular appraisers and the resulting possibility  
15 of litigation. CW 23 further stated that eAppraiseIT was also concerned about how the so-called  
16 “preferred” appraisers would be coded into eAppraiseIT’s computer management systems. In  
17 sum, CW 23 explained that eAppraiseIT was fearful of liability, loss of contract, and litigation.  
18 For these reasons, CW 23 stated that, at various times, WaMu’s list was referred to as  
19 “preferred,” “proven,” and “approved.” CW 23 could not recall the order in which these names  
20 were used, but stated that as time went on WaMu and eAppraiseIT “attempted to make the list  
21 sound more and more generic.” As detailed below, these cosmetic changes to the names given to  
22 WaMu’s hand-picked lists of appraisers were discussed at the highest levels of WaMu and  
23 eAppraiseIT.  
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1           212. CW 23 revealed that the original list of appraisers that WaMu provided to  
2 eAppraiseIT was created with the WaMu Sales Department's input and approval. According to  
3 CW 23, as the list was sent through WaMu's Sales Department before making its way over to  
4 eAppraiseIT, WaMu freely added appraisers known to "hit value, do favors, etc." In addition,  
5 according to CW 23, WaMu instructed eAppraiseIT that eAppraiseIT could not use its own staff  
6 appraisers for WaMu appraisals, a situation that eAppraiseIT found to be unacceptable. CW 23  
7 stated that to address this, eAppraiseIT hired numerous former WaMu in-house staff appraisers.  
8 However, CW 23 explained, some of these appraisers were still not included by WaMu on its list,  
9 causing substantial disagreements between eAppraiseIT and WaMu. In particular, CW 23 noted  
10 that eAppraiseIT questioned why WaMu refused to add certain eAppraiseIT staff appraisers that  
11 had worked for WaMu for 10 years or more onto WaMu's list; likewise, the list included  
12 appraisers that CW 23 felt very uncomfortable retaining. According to CW 23, eAppraiseIT  
13 promptly informed WaMu that WaMu's list was flawed and that many of the appraisers listed  
14 needed to be removed. Nevertheless, according to CW 23, with WaMu's explicit knowledge and  
15 consent, the first list "had remained in effect for about six months." CW 23 stated that it was his  
16 understanding that there was direct communication between eAppraiseIT and the head of  
17 WaMu's Mortgage Division regarding the problems created by WaMu's "preferred list."  
18

19  
20           213. During the first six months that WaMu and eAppraiseIT worked together,  
21 according to CW 23, the Appraisal Management Department at eAppraiseIT would regularly  
22 receive phone calls from WaMu instructing eAppraiseIT to add or remove appraisers from  
23 WaMu's list. According to CW 23, anyone at WaMu who had eAppraiseIT's phone number  
24 could call and order a change to the list – it was "wide open."  
25  
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1           214. CW 23 stated that, particularly during the first six months when WaMu's list of  
2 appraisers was "wide open" to its loan production personnel, *"appraisers were being removed*  
3 *for not hitting value."* As a result, CW 23 explained, even after the process was modified,  
4 appraisers feared being removed from WaMu's list and therefore not receiving work.

5           215. CW 23 explained that during that first six months of WaMu's outsourcing to  
6 eAppraiseIT, daily conference calls were conducted between WaMu and eAppraiseIT to address  
7 various issues. Among the issues discussed during those calls, CW 23 stated that during those  
8 calls, eAppraiseIT raised "how inappropriate" WaMu's procedures were of allowing any WaMu  
9 employee to modify the list of appraisers WaMu required eAppraiseIT to use, among other  
10 issues. According to CW 23, Maryann Garfield, a Vice President and Senior Appraiser at  
11 eAppraiseIT, participated in the daily conference calls with the WaMu panel, along with  
12 approximately five people from WaMu's Appraisal Panel, including the head of the appraisal  
13 group at WaMu. CW 23 stated that these daily conference calls "focused a great deal on how to  
14 manage the appraiser list, how to add and subtract appraisers, and what to call the list." CW 23  
15 felt that Garfield was always "very strong," and she frequently said in their preparations for the  
16 calls that eAppraiseIT had to "push back" on the unreasonable demands. According to CW 23,  
17 during these calls, Garfield would inform the WaMu's representatives in a businesslike manner  
18 that she believed that WaMu's practices concerning which appraisers were added or subtracted to  
19 WaMu's list and WaMu telling eAppraiseIT which appraisers to use were wrong.

20           216. CW 23 also stated that several of these daily conference calls included both  
21 eAppraiseIT and LSI, although WaMu did try to separate the companies when discussing certain  
22 issues. In addition, CW 23 explained that WaMu tried to pit the two companies against each  
23 other and referred to this tactic as the "Champion Challenger." For example, according to CW  
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23, WaMu would goad eAppraiseIT by suggesting that LSI was performing better in certain areas than eAppraiseIT was, and vice versa. WaMu was able to get eAppraiseIT to agree to their demands by using this tactic.

217. According to CW 23, many of WaMu's loan officers were very unhappy when WaMu decided to outsource its appraisal function because they were unsure whether they could continue to drive through loans as they had with WaMu's in-house appraisers. Some WaMu loan officers threatened to quit unless they were offered "sweetheart deals" or WaMu assured them that they could continue with business as usual, according to CW 23. In response, CW 23 stated that WaMu's high producing loan consultants were placed on a preferred list and received some preferred treatment with respect to appraisals. For instance, these loan consultants had a guaranteed "turn time."

218. CW 23 understands that WaMu had an actual procedure in place documenting the existence of and governing WaMu's list of high-producing loan consultants receiving even more preferential treatment than standard WaMu loan consultants regularly received. In fact, CW 23 stated, there was a "loan consultant counsel" at WaMu that met to discuss issues that affected WaMu's loan consultants, including appraisals. WaMu's "loan consultant counsel" served as an avenue for WaMu loan consultants to offer WaMu managers feedback. Indeed, WaMu's "loan consultant counsel" met regularly at set times with WaMu's senior management, according to CW 23, including "the head of WaMu's Mortgage Division."

219. According to CW 23, after the first six months of WaMu outsourcing appraisals to eAppraiseIT (or approximately January 2007), WaMu created a second list with rules about how appraisers could be added and removed from WaMu's list. However, according to CW 23, WaMu's second list was still improper as it *again* received input and approval from WaMu's



1 Sales Department, although this time only by WaMu regional managers and above. Therefore,  
2 according to CW 23, WaMu loan officers would only have to pass their requests on to their  
3 regional managers to add or remove appraisers to or from WaMu's "preferred" appraiser list.  
4 Also at this time, CW 23 stated that only WaMu regional managers had the authority to add or  
5 remove an appraiser by phone, which they could do at least once a month.  
6

7 220. CW 23 also said that WaMu's ROV process was problematic. According to CW  
8 23, WaMu had a set process in place where the loan officer could send the appraisal back with  
9 additional data or comps. CW 23 explained that when requesting an ROV, WaMu had to provide  
10 written documentation of the request.

11 221. According to CW 23, in theory, WaMu was only supposed to have one  
12 opportunity for an ROV: if WaMu disagreed with an appraisal value, it was supposed to explain  
13 to eAppraiseIT why and provide necessary additional data for eAppraiseIT to research. CW 23  
14 stated that 60% to 70% of the ROVs that he received from WaMu were frivolous and did not  
15 include any meaningful or specific new information. He described many of the ROV requests  
16 from WaMu as follows: "My house is better than you said it was" or "How could you appraise it  
17 so low." Nevertheless, CW 23 explained that the reality was that additional ROVs – even ROVs  
18 that had no new information – could be requested until WaMu was satisfied. In addition, as  
19 explained by CWs 31, 23, 42, it was actually eAppraiseIT's and LSI's appraisers that were often  
20 forced to justify in detailed writing all reasons why they would decline to increase appraisal  
21 values.  
22

23  
24 222. CW 23 explained that the ROV process for WaMu "was so easy," and certainly  
25 easier for a WaMu loan officer to submit an ROV than to go to his or her client and inform the  
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1 client that the client's loan would not close, which would have been contrary to the frequent  
2 promises WaMu loan consultants made to their client that loans would "hit value" and close.

3 223. Initially, when WaMu's appraisal outsourcing started, CW 23 stated that he was  
4 receiving quite a few ROVs from WaMu – over 100 a day just for Southern California – which  
5 he described as "chaotic." Every ROV from CW 23's area had to go through him, and CW 23  
6 explained that at one point he was therefore focused only on ROVs. According to CW 23,  
7 eAppraiseIT began to push back on WaMu concerning ROVs, and the number of ROVs from  
8 WaMu began to slowly decrease after about 6 months.

10 224. CW 23 explained that he typically would review ROV requests before forwarding  
11 them to appraisers. Many times, CW 23 felt that ROV requests were unwarranted, but because  
12 he could not tell for certain from his desk, he would still send the requests to the responsible  
13 appraisers for further review. If the appraiser did not feel that the value should be changed, the  
14 appraiser would return the ROV request to CW 23. In such circumstances, CW 23 would then  
15 inform WaMu of the appraiser's decision to decline WaMu's ROV request.

17 225. According to CW 23, WaMu had a long-standing policy that appraisal managers  
18 could review appraisals and take responsibility for the value increase if they disagreed with  
19 values reflected in initial appraisals, but eAppraiseIT did not follow this procedure because it  
20 was worried about the legality of such practices.

22 226. Although CW 23 was supposed to "be a gatekeeper to the appraisers," appraisers  
23 still received calls directly from WaMu loan officers. CW 23 explained that while he tried to  
24 discourage this contact, the appraisers were so worried about their livelihood that they generally  
25 did not refuse it. CW 23 said that there was definitely an implication that if appraisers did not  
26 meet "WaMu's standard," they would be removed from WaMu's list and would not receive work.

1 According to CW 23, it was common knowledge among appraisers who performed work for  
2 WaMu that if they were on WaMu's preferred list, they were "still in business." However, if they  
3 were cut, they would need to find new sources of work.

4 227. WaMu employees also inappropriately contacted CW 23 directly. According to  
5 CW 23, "everyone at WaMu knew [him]," and certain WaMu employees knew how to contact  
6 him. CW 23 stated that it was improper to handle things in this manner, but that "it was just how  
7 things worked." CW 23 explained that he would get resistance from WaMu when he would deny  
8 values in response to such contact from WaMu.

10 228. CW 23 also noted that in 2006 and 2007, home values were typically declining.  
11 According to CW 23, if an appraiser marked "declining" on an appraisal report (noting the fact  
12 that market values for other homes in the area were declining), then the underwriter for that loan  
13 was supposed to automatically "cut" the maximum LTV allowed for the loan by 5% (*e.g.*, from an  
14 allowed LTV ratio of 80% to 75%) — a change "that would kill the loan." CW 23 stated that "a  
15 lot of appraisers were gun-shy because WaMu was blackballing appraisers, fees were being cut,  
16 and a lot of people were not getting work." Therefore, according to CW 23, many appraisers  
17 were intimidated by WaMu into marking "stable" on appraisals even when they knew the value  
18 to be declining and that "declining" was the appropriate designation. CW 23 said that appraisers  
19 working for WaMu felt this pressure during his entire tenure at eAppraiseIT.

22 229. CW 32 worked for eAppraiseIT in Danvers, MA from March 2004 to March  
23 2007, starting as a Customer Service Representative ("CSR") and becoming a Business Analyst  
24 around 2005. As a CSR, CW 32 handled phone calls from appraisers and clients regarding  
25 questions about appraisal reports and appraisal status.

1           230. CW 32 understood that WaMu had used certain appraisers before the Company  
2 outsourced appraisal work to eAppraiseIT, under the guise that eAppraiseIT was supposed to be  
3 unbiased and uninfluenced by WaMu. However, CW 32 observed that WaMu began setting up a  
4 panel of appraisers made up of those same appraisers it had been using in the first place. CW 32  
5 further learned that those appraisers were even being managed by the same people that had  
6 managed them previously at WaMu, and that eAppraiseIT was hiring these managers directly  
7 from WaMu. CW 32 first heard about these practices from his boss Susan Ramey, who was in  
8 charge of the Appraisal Management Department, which oversaw the eAppraiseIT appraisers.  
9

10           231. CW 32 explained that neither CW 32 nor Ramey understood how WaMu's  
11 "situation with eAppraiseIT" was any different or better than WaMu's in-house appraisal  
12 practices before WaMu elected to outsource its appraisal work. CW 32 stated that the general  
13 sense at eAppraiseIT was, "WaMu is this big, powerful company that can give us a lot of  
14 business so get them and then afterwards appease them." Because of this dynamic, according to  
15 CW 32, "[eAppraiseIT] *really did bend over backwards to do basically anything WaMu*  
16 *wanted.*"  
17

18           232. CW 33 worked at eAppraiseIT in Beaverton, Oregon in 2007, and reported to  
19 Cheryl Henderson, eAppraiseIT's manager of incoming and outgoing calls for WaMu.  
20

21           233. CW 33 was initially responsible for following up with appraisers in several states  
22 about past due reports, after which she started handling inbound and outbound calls with WaMu  
23 loan officers and appraisers. While some WaMu loan officers called to check on the status of the  
24 appraisal reports or other routine matters, however, CW 33 stated that many WaMu loan officers  
25 called eAppraiseIT because they were dissatisfied with appraisal values and insisted that the  
26  
27

1 appraisal reports were wrong. CW 33 dealt mostly with WaMu loan officers, but the WaMu  
2 branch managers also called CW 33 to complain about appraisal values.

3 234. CW 33 explained that WaMu loan officers would ask to speak directly with  
4 appraisers. Although CW 33 was not allowed to provide a WaMu loan officer with an  
5 appraiser's number, the WaMu loan officers sometimes said that they already had the appraiser's  
6 number and were going to call the appraiser directly. Additionally, CW 33 explained that after  
7 the appraisal report actually came in, many WaMu loan officers contacted the appraisers directly  
8 to challenge the appraisal values because at that point, the WaMu loan officers had access to the  
9 appraisers' numbers from the appraisal reports.  
10

11 235. If WaMu disagreed with the value of an appraisal, CW 33 explained, WaMu could  
12 submit an ROV, which was then supposed to include three to five comps that supported a higher  
13 value. If the appraiser did not feel that the new comps were comparable, he would return the  
14 same value as before. At that point, CW 33 stated that some WaMu loan officers would send the  
15 file to a different appraiser, who they would also pressure to increase the initial appraisal value.  
16

17 236. CW 33 further expressed that only "preferred appraisers" could handle WaMu  
18 business, and appraisers were removed from the "preferred list" if an appraiser did not perform  
19 according to WaMu's expectations.  
20

21 237. CW 34 was a real estate appraiser for eAppraiseIT from June 2006 to December  
22 2007. Like most of eAppraiseIT's appraisers, CW 34 worked from home and received her work  
23 orders electronically. CW 34 reported to Peter Gailitis, eAppraiseIT's Chief Appraiser, who CW  
24 34 believes was terminated by eAppraiseIT around the third quarter 2007. CW 34 also noted that  
25 CW 23 managed eAppraiseIT's appraisers.  
26  
27

1           238. Initially, almost all of CW 34's work came from WaMu. Around June or July of  
2 2007, CW 34's WaMu appraisal orders dropped from 15-20 orders a week to two orders a month.  
3 CW 34 stated that shortly after CW 34's workload had dropped, CW 23 held a conference call  
4 with all of eAppraiseIT's west coast appraisers to inform the appraisers that their workload had  
5 plummeted because WaMu had decided to use only "selected" appraisers. According to CW 34,  
6 CW 23 explained that WaMu was no longer classifying eAppraiseIT appraisers as "preferred."  
7 CW 34 stated that this was primarily due to the eAppraiseIT appraisers not "bringing in the value  
8 of homes" that WaMu wanted.  
9

10           239. CW 34 also explained that ultimately WaMu cut her off from doing appraisals  
11 because she refused to increase appraisal values in response to WaMu ROVs. Specifically, on  
12 several occasions, WaMu demanded to know why CW 34 did not use certain comps and supplied  
13 different comps for CW 34 to use. CW 34 refused to use those comps because they were either  
14 outside of the relevant geographic area or because they were too old to be relevant. For example,  
15 some of the comps provided to CW 34 by WaMu were over a year old, dating back to when  
16 home values were higher, or were within a wealthier neighborhood. According to CW 34,  
17 concerning ROVs, WaMu typically urged an increase in value of at least \$20,000-\$25,000 for  
18 homes that CW 34 appraised in the \$500,000 range. CW 34 refused to change the value of such  
19 appraisals and, after a few outright refusals to change value on the basis of WaMu's inappropriate  
20 comps, WaMu completely cut off CW 34 from WaMu business.  
21  
22

23           240. CW 35 served as an eAppraiseIT Customer Service Representative and an  
24 eAppraiseIT Account Manager for WaMu, working out of the Poway, California location. CW  
25 35 received and processed appraisal requests for Washington, Oregon, and some areas of  
26 California, and then found appraisers in the local area to handle the request.  
27

1           241. According to CW 35, WaMu was extremely particular regarding who did the  
2 appraisals for WaMu loans. CW 35 was instructed to “do his best” to find an appraiser on  
3 WaMu’s list. If CW 35 was unable to do so, CW 35 was required to get WaMu’s permission to  
4 use an appraiser not on the list. Specifically, he said that when he could not find a WaMu  
5 preferred appraiser, CW 35 was forced to call WaMu and explain to WaMu that a WaMu-  
6 preferred appraiser in the area was not available, but that another appraiser on eAppraiseIT’s list  
7 “could do the appraisal by the turnaround time [that WaMu required].” CW 35 also had to ask  
8 whether WaMu had any recommended appraisers in the area. If WaMu did have  
9 recommendations, CW 35 was required to add the recommended appraisers to the eAppraiseIT  
10 panel and to WaMu’s preferred appraisers list.

12           242. According to CW 35, once an appraiser rendered the appraisal value, WaMu  
13 frequently disagreed with the value. CW 35 explained that the arrangement between WaMu and  
14 eAppraiseIT allowed a WaMu loan officer to send to eAppraiseIT an ROV at no cost to WaMu,  
15 and that WaMu loan officers would often include additional comps to support the value that they  
16 were looking for. CW 35 would then send the appraisal back to the original appraiser. Many  
17 appraisers, CW 35, recalled, disliked this practice because they felt that they should not have to  
18 increase the value of the property simply because the WaMu loan officer provided some  
19 additional comps. And, according to CW 35, many of the appraisers felt that WaMu’s practices  
20 were “against the rules.” Indeed, CW 35 recalled that WaMu placed a great deal of pressure on  
21 appraisers to raise appraisal value. For example, if an eAppraiseIT appraiser was not willing to  
22 use WaMu’s comps, the WaMu loan officer would call CW 35’s department and complain that  
23 the “appraiser was inadequate.”  
24  
25  
26  
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1           243. According to CW 35, eAppraiseIT appraisers would sometimes refuse to raise  
2 appraisal values on the basis of WaMu's comps. To circumvent these refusals, WaMu required  
3 eAppraiseIT to keep Appraisal Business Managers, or ABMs, onsite at CW 35's location. CW  
4 35 stated that these ABMs, or even eAppraiseIT's Vice President of Operations, would review  
5 the appraisals when the appraiser refused to raise the value on an ROV, and often they would call  
6 the appraisers to "guide them through on how to raise the value." CW 35 noted that if, even after  
7 the ABMs or the Vice President of Operations "guided" the appraiser, the appraiser still would  
8 not raise the value, eAppraiseIT would often simply find a new appraiser to handle the appraisal.

10           244. CW 35 confirmed that when WaMu complained about an appraiser, eAppraiseIT  
11 had to remove that appraiser from the eAppraiseIT panel and the WaMu preferred list. CW 35  
12 recalled appraisers being removed because WaMu did not like the comps they used and the  
13 appraiser was not willing to increase the value when WaMu loan officers complained.

15           245. CW 35 recalled that "95%" of the appraisers on WaMu's preferred list had  
16 formerly worked at WaMu as appraisers and, because of this prior relationship, WaMu loan  
17 officers would often contact their former colleagues at eAppraiseIT directly. According to CW  
18 35, all contact should have gone through CW 35's department, but WaMu loan officers would  
19 often call the appraiser directly to pressure the appraiser to raise appraisal value. CW 35 recalled  
20 that "loan officers seemed to be dictating more than Appraisal Panel Management was." Indeed,  
21 CW 35 actually overheard telephone calls in which WaMu loan officers yelled at eAppraiseIT  
22 upper management including Peter Gailitis, eAppraiseIT's Chief Appraiser, to "fix appraisals  
23 because WaMu was not getting the value it wanted."

25           246. CW 35 reported that there were many more ROVs for WaMu than for any other  
26 customer. eAppraiseIT received 100-200 ROVs a day, if not more, for WaMu. CW 35  
27



1 personally handled 15-20 ROVs each day for WaMu. Typically, CW 35 recalled, if a ROV on an  
2 appraisal that had been done by an appraiser on the eAppraiseIT panel was then sent to a WaMu  
3 panel appraiser, the value increased.

4 247. CW 35 described eAppraiseIT's relationship with WaMu as follows: "Most of the  
5 time, we tried to bend over backwards and do whatever we could to help them." CW 35 said that  
6 some of WaMu's requests "went against appraisal laws and appraiser ethics," but, because of the  
7 severe pressure placed upon eAppraiseIT by WaMu, eAppraiseIT would "always try to find a  
8 way around this problem to help WaMu."  
9

10 248. CW 36 worked in eAppraiseIT's Appraisal Management Department from  
11 October 2006 to August 2007. CW 36 reported to Sue Ramey, eAppraiseIT's appraisal  
12 management supervisor and handled the recruiting of appraisers and tried to "to satisfy. . .  
13 WaMu's demands for appraisals."  
14

15 249. CW 36 explained that "WaMu was eAppraiseIT's biggest client, and the  
16 appraisers on WaMu's preferred list got all of its work." According to CW 36, eAppraiseIT "had  
17 to fulfill more and more of WaMu's demands each week," and WaMu placed "additional  
18 demands" on eAppraiseIT "all the time."  
19

20 250. According to CW 36, eAppraiseIT management discussed how some of WaMu's  
21 demands on eAppraiseIT were unethical. In particular, CW 36 stated that Sue Ramey and her  
22 boss (in quality control appraisal management) said that they did not approve of WaMu's  
23 appraisal demands and that eAppraiseIT needed to "push back" on WaMu. However, according  
24 to CW 36, Ramey was not in a position to actually do so. CW 36 believes that eAppraiseIT was  
25 willing to acquiesce to WaMu's demands because WaMu was eAppraiseIT's biggest client;  
26 according to CW 36, other eAppraiseIT employees shared his view.  
27

1           251. CW 36 stated that 90% of the appraisers WaMu preferred were appraisers that  
2 WaMu had contracted with in the past, and most were formerly employed by WaMu. CW 36  
3 explained that WaMu could remove appraisers from any of its preferred lists at its whim, and that  
4 *every week WaMu would send eAppraiseIT a list of appraisers to add and appraisers to*  
5 *remove.* According to CW 36, “WaMu did not provide reasons for the changes; the Company  
6 merely stated who it was willing to work with.”  
7

8           252. Approximately one month before CW 36 left eAppraiseIT, CW 36 was reassigned  
9 to handle WaMu ROVs. According to CW 36, WaMu was generally asking for higher values on  
10 appraisals in connection with its ROVs, and CW 36 would have to speak to WaMu loan officers  
11 about why they were ordering a new appraisal. Also, sometimes appraisers would call CW 36 to  
12 complain about ROVs (also called rebuttals) they received. In some instances, CW 36 stated, the  
13 appraisers had already received multiple rebuttals because they were not “coming in at the right  
14 value,” and the appraisers felt that WaMu would continue to rebut them until they agreed to  
15 increase the value.  
16

17           253. CW 37 served at eAppraiseIT as a Customer Service Representative in Poway,  
18 California from June 2005 to October 2007. CW 37 was in charge of the priority service clients,  
19 or high profile loan officers at WaMu. In this capacity, CW 37 served “about sixty” WaMu  
20 priority service clients.  
21

22           254. CW 37 confirmed that WaMu would “contact appraisers directly to discuss any  
23 issues because they were accustomed to doing so in the past.” According to CW 37, even after  
24 WaMu’s outsourcing was firmly established (*i.e.*, after six months or so) appraisers would call  
25 CW 37 to complain that WaMu continued to contact them directly. CW 37 believed that WaMu  
26 was using this “tactic” in order to manipulate appraisal values. Indeed, CW 37 explained that  
27

1 although WaMu loan officers “sometimes contacted the appraiser to check on status, *most of the*  
2 *time they called to scream about the value” being too low.*

3 255. CW 37 also explained that appraisers working on behalf of WaMu “would get an  
4 estimated value for home purchases” that would influence their valuation decisions.

5 256. CW 38 worked at eAppraiseIT as a Customer Service Representative in 2006.  
6 During this time, CW 38 worked with WaMu, and explained that WaMu was a central reason that  
7 she left eAppraiseIT. CW 38 stated that WaMu made “too many demands,” some of which CW  
8 38 found to be unethical. For example, CW 38 stated that WaMu loan officers would call  
9 eAppraiseIT to demand that appraisals be completed in a shorter time frame than policy dictated.  
10 In addition, CW 38 complained that *WaMu would demand increases in appraisal values,*  
11 *frequently by requesting an ROV or submitting a rebuttal.*

12 257. CW 38 explained that if a WaMu loan officer was dissatisfied with an  
13 eAppraiseIT appraiser’s denial of an ROV or if a loan was riding on an appraisal, WaMu’s  
14 request would be escalated above that appraiser’s level.

15 258. CW 38 stated that WaMu wanted to pick its own appraisers by name for each  
16 individual appraisal, but eAppraiseIT would not allow that. According to CW 38, eAppraiseIT  
17 did, however, agree to send appraisals only to those on the WaMu’s preferred list as a  
18 compromise.

19 259. CW 38 also stated that WaMu loan officers sometimes called eAppraiseIT  
20 directly; CW 38 stated that in response, she always informed WaMu loan officers not to call the  
21 appraisers directly.

22 260. Due to her experiences at eAppraiseIT, CW 38 “walked out in the middle of lunch  
23 one day and never looked back.”

**c. Documents Obtained by the New York Attorney General and the Allegations of the NYAG Complaint Further Confirm That Senior WaMu Management Directed WaMu's Wrongful Appraisal Practices**

261. Lead Plaintiff's investigation has adduced facts, alleged herein, that show WaMu's systematic manipulation of appraisals during the Class Period. The NYAG Complaint, which is available online at: <http://www.oag.state.ny.us/press/2007/nov/EA%20Complaint.pdf>, is consistent with the factual allegations herein. Indeed, various internal, non-public documents quoted in the NYAG Complaint that offer additional, corroborating evidence of Defendants' direct involvement in the appraisal manipulation alleged herein are set forth below.

262. A *New York Times* article dated November 2, 2007 – one day after the NYAG Complaint was filed – explained that the NYAG Complaint was, according to New York Attorney General Andrew Cuomo, filed only after “investigators had spent nine months interviewing hundreds of mortgage industry executives and poring over millions of documents obtained through subpoenas.” The November 2, 2007 *New York Times* article further explained that the NYAG Complaint was, at least in part, “built on e-mail messages obtained through a subpoena to First American.”

263. Consistent with Lead Plaintiff's investigation, the NYAG Complaint alleges that contemporaneous with WaMu outsourcing its appraisal business to eAppraiseIT and LSI, WaMu's loan production staff often complained that the appraisal values provided by eAppraiseIT appraisers were not as high as WaMu wanted (as they had with WaMu's in-house appraisers), and as a result WaMu acted to increase appraisal values through improper means.

264. According to the NYAG Complaint, on August 9, 2006, eAppraiseIT's President communicated to WaMu executives that “[w]e need to address the ROV issue . . . . Many lenders

1 in today's environment . . . have no ROV issue. The value is the value. I don't know if WaMu  
 2 production will go for that . . . . The WaMu internal staff we are speaking with admonish us to be  
 3 certain we solve the ROV issue quickly or we will all be in for some pretty rough seas."

4 265. According to the NYAG Complaint, only one week later, on August 15, 2006,  
 5 eAppraiseIT's Executive Vice President advised eAppraiseIT's President in writing that WaMu's  
 6 loan officers would often pressure WaMu's internal appraisal field managers for an "extra few  
 7 thousand," or "tell[] them specifically what they needed," or would "ask for several ROVs on the  
 8 same property."

10 266. According to the NYAG Complaint, by email dated September 29, 2006, a WaMu  
 11 executive wrote to eAppraiseIT's senior executives to define eAppraiseIT personnel's  
 12 responsibilities as to ROVs and value disputes:

14 . . . the four appraisers/reviewers would be directly involved in escalations dealing  
 15 with: ROVs, Valuation issues where the purchase price and appraised value differ  
 16 with no reconciliations/justifications by the appraiser, Value cuts which we  
 17 continue to receive from your third party reviewers (Wholesale), ***proactively  
 making a decision to override and correct the third party appraiser's value or  
 reviewer's value cut***, when considered appropriate and supported . . . .

18 (Emphasis in NYAG Complaint.) According to the NYAG Complaint, the "four  
 19 appraisers/reviewers" were former WaMu employees that WaMu had pushed eAppraiseIT to  
 20 hire in supervisory positions. Thus, according to this document cited in the NYAG Complaint,  
 21 WaMu sought to ensure, through pressure on eAppraiseIT, that appraisals came in at the high  
 22 values that WaMu wanted.

23 267. According to the NYAG Complaint, in February 2007, WaMu directed  
 24 eAppraiseIT to stop using eAppraiseIT's usual panels of staff and fee appraisers to perform  
 25 WaMu appraisals. Instead, according to the NYAG Complaint, WaMu demanded that  
 26 eAppraiseIT use a "proven panel" of appraisers selected by WaMu loan origination staff, who  
 27

were chosen because they provided high values. According to the NYAG Complaint, during this time a WaMu Vice President in the Appraisal Oversight group explained, in an email to eAppraiseIT about an ROV for a “low value,” that “[t]his is an example of the issue that has caused sales pushing for a ‘proven appraiser’ process.”

268. According to the NYAG Complaint, in February 2007, eAppraiseIT “simply capitulated to WaMu’s demands”: in an email on February 22, 2007, eAppraiseIT’s President told senior executives at First American “*we have agreed to roll over and just do it.*” According to the NYAG Complaint, eAppraiseIT’s President explained that “we were willing to live with the change if [WaMu] would back us up with the appraisers and tell them that simply because they are rated as Gold Preferred does not mean that they can grab all the fees. [WaMu] agreed.” Indeed, according to the NYAG Complaint, eAppraiseIT’s President wrote about steps necessary to implement WaMu’s plan, and also WaMu’s desire to “stop the noise” surrounding WaMu’s need to increase appraisal values that led to the changes:

[eAppraiseIT] should have Wamu write the introduction letters to their appraisers, set the stage and let us do our magic . . . . I assured her the noise from retail will stop . . . . She brought up the fact that Wamu knows this means little money to no money for [eAppraiseIT] and LSI and [WaMu] will fix that in the near future. But for now they need to stop the noise or none of us will be around. I believe her.

269. Also according to the NYAG Complaint, by email dated February 22, 2007, eAppraiseIT’s President explained to senior executives at First American WaMu’s motives for demanding a “proven panel” of appraisers:

We had a joint call with Wamu and LSI today. The attached document outlines the new appraiser assigning process. In short, we will now assign all Wamu’s work to Wamu’s “Proven Appraisers” . . . . We will pay their appraisers whatever they demand. *Performance ratings to retain position as a Wamu Proven Appraiser will be based on how many come in on value, negating a need for an ROV.*

(Emphasis in NYAG Complaint.)

270. According to the NYAG Complaint, in an email dated March 1, 2007, eAppraiseIT's President told WaMu executives:

Recently, we have been notified that Lending would like us to use more of their "Proven Appraisers" versus appraisers off our pre-selected appraiser panel. It seems the amount of Reconsideration of Value (ROV) requests associated with our appraisers far exceeds those initiated when a WaMu proven appraiser completes a file. Said differently, ***Wamu proven appraisers bring the value in a greater majority of the time*** with minimal involvement of the vendor, sales and Appraisal Oversight. ***I am fine with that, of course, and will happily assign Wamu orders to Wamu proven appraisers instead of eAppraiseIT's approved panel appraiser whenever possible.***

(Emphasis in NYAG Complaint.)

271. In addition, according to the NYAG Complaint, on April 4, 2007, eAppraiseIT's Executive Vice President wrote an email to senior eAppraiseIT executives regarding eAppraiseIT's legal liability for using WaMu's "proven list." According to the NYAG Complaint, the eAppraiseIT EVP explained that appraiser independence is chiefly:

***the lender's responsibility since the OCC [Office of the Comptroller of the Currency]/OTS only pertain to lenders.*** However, we as an AMC need to retain our independence from the lender or it will look like collusion. Imagine a simple mortgage broker saying he will give us the work if we use his "proven" appraiser. We say no. This is very similar to that except they are very big. . . .

So the push back to WAMU needs to be (assuming we want to do this some day), eAppraiseIT needs to choose the appraisers, not WAMU. Where it gets ***really*** clear that eAppraiseIT is NOT choosing is the proven idea because they always go first and MUST be selected unless there is a specific reason why not. ***eAppraiseIT is clearly being directed who to select. The reasoning that there are fewer ROVs is bogus for many reasons including the most obvious – the proven appraisers bring in the values.***

Fun, eh??

272. Furthermore, according to the NYAG Complaint, on May 29, 2007, eAppraiseIT's Executive Vice President communicated the problems in the eAppraiseIT/WaMu relationship in a letter to a WaMu senior executive as follows:



1 In the first quarter of 2007, the sales group of WAMU began to insist they choose  
 2 the appraisers mostly due to their concerns about 'low values.' eAppraiseIT  
 3 encouraged WAMU to resist these pressures if possible. However, WAMU  
 4 decided to go with what came to be called the "proven" list of appraisers  
 5 recommended by sales. . . .

6 The use of the "proven panel is challenging for eAppraiseIT in two ways: A.  
 7 Financially – The proven panel is paid a minimal [sic] of 20% more than the  
 8 eAppraiseIT panel. B. Risk Management – the possibility of collusion between  
 9 the loan officers and appraisers is increased when eAppraiseIT does not control  
 10 the selection. In addition, eAppraiseIT is concerned with any possible lender  
 11 pressure or perception of lender pressure when the only way to get on the WAMU  
 12 "proven" panel is through the loan officer.

13 According to the NYAG Complaint, despite the "possibility of collusion" raised by eAppraiseIT,  
 14 the only change made in response to the message quoted above was that on June 7, 2007, a  
 15 WaMu executive directed eAppraiseIT to change the name of the Proven List for the following  
 16 reasons: "Name change from 'proven appraiser' and/or use of the moniker 'PAL' list is  
 17 discontinued, under direction of the WaMu legal department. We are utilizing a more generic  
 18 term acceptable w/in regulatory guidelines and industry standards." Thereafter, according to the  
 19 NYAG Complaint, the Proven Appraiser Panel was simply renamed the "WaMu Select" panel.

20 273. The detailed allegations of the NYAG Complaint, including the internal WaMu  
 21 and eAppraiseIT documents quoted in the NYAG Complaint and set forth herein, further show  
 22 that WaMu and the Officer Defendants knew or recklessly disregarded WaMu's blatant appraisal  
 23 interference, notwithstanding Defendants' portrayal to the public that WaMu's business practices  
 24 were entirely above board.

25 **d. Numerous LSI-affiliated Persons**  
 26 **Witnessed WaMu's Systematic**  
 27 **Manipulation of the Appraisal Process**

28 274. As detailed by numerous persons affiliated primarily with LSI during the Class  
 Period with percipient knowledge of WaMu's dealings with LSI, the systematic, improper



1 interference with the appraisal process by WaMu in its efforts to increase appraisal values  
2 whenever possible was not restricted to WaMu's internal practices or the Company's interactions  
3 with eAppraiseIT. In fact, these witnesses explain in detail that WaMu also inappropriately  
4 caused appraisals sourced through LSI to be improperly inflated through the same tactics used to  
5 pressure eAppraiseIT and its appraisers.

6  
7 275. According to CW 39, a member of LSI's appraisal management team for WaMu  
8 from August 2006 through February 2007, WaMu was LSI's largest client. CW 39 stated that  
9 LSI was forced to give priority to appraisers from a WaMu "preferred appraisal" list for its  
10 appraisals.

11 276. According to CW 39, WaMu frequently attempted to steer appraisal values  
12 upward by (1) submitting ROVs, (2) through WaMu loan officers contacting appraisers directly,  
13 and (3) by WaMu loan officers requesting to work with specific appraisers because "they knew  
14 each other."

15  
16 277. CW 39 remarked that although WaMu loan officers contacting LSI was "illegal,"  
17 it happened frequently. CW 39 also characterized WaMu's efforts to dictate which specific  
18 appraisers should be used as "illegal," and as a practice that LSI would acknowledge but re-  
19 construe as a "recommendation" from WaMu. CW 39 stated that when WaMu made such a  
20 demand, he typically would use the appraiser "recommended" by WaMu.

21  
22 278. CW 40 worked at LSI as a Customer Service Representative and Reviewer during  
23 2007 through 2008. CW 40's contact with WaMu was through LSI's Client Services division,  
24 which was responsible for servicing LSI's business relationship with WaMu.

25 279. CW 40 explained that WaMu representatives were often unhappy when property  
26 comparables came in at values lower than WaMu desired. Under such circumstances, CW 40  
27

1 was instructed by LSI Client Services to call the appraiser and instruct him to look for “better”  
2 comps.

3 280. According to CW 40, sometimes when CW 40 would contact appraisers to request  
4 that they use “additional comps,” the appraisers would refuse, stating that they had “already used  
5 the best comps and that there were no other good comps out there.” In these cases, an LSI  
6 supervisor would contact the appraisers and inform them that they have to find additional comps  
7 reflecting higher values or they would not get paid.  
8

9 281. CW 40 also stated that he received approximately 5-10 ROVs per week from  
10 WaMu, and that this number may have been understated because ROVs were often reclassified at  
11 LSI so that it would not appear that WaMu was asking for multiple ROVs. However, even with  
12 this adjustment, CW 40 stated that he has received appraisals back from WaMu as many as three  
13 times that seek ROV. In addition, according to CW 40, appraisers were required to provide  
14 “elaborate details” about anything that they found to lower the value of a home they were  
15 appraising for a WaMu loan, although no such requirements were imposed to increase the value  
16 of an appraisal.  
17

18 282. CW 40 confirmed that LSI appraisals for WaMu were accomplished by using  
19 appraisers from a “preferred list” dictated by WaMu, and that only certain appraisers were to be  
20 used in specific areas. In fact, CW 40 stated that LSI was occasionally forced by WaMu to pay  
21 an appraiser more because WaMu did not want LSI to use the appraiser that was in the area. For  
22 example, CW 40 stated that WaMu would insist on using a “preferred” appraiser twenty miles  
23 from a property, as opposed to a licensed appraiser who was not on WaMu’s list but who was  
24 located “right down the street” from the property to be appraised.  
25  
26  
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1           283. CW 41, a Customer Service Representative at LSI during 2007, confirmed that  
2 LSI appraisers would often call her to complain that WaMu representatives were calling them  
3 directly, which was against policy and required a phone call to her supervisor. According to CW  
4 41, while she was at LSI this would happen approximately twice a day.

5           284. Similarly, CW 42, who worked at LSI during 2007 in Customer Relations and  
6 who serviced WaMu confirmed that WaMu required LSI to use only "preferred appraisers," the  
7 list of which was dictated by and amended upon specific requests (sometimes one name at a  
8 time) by WaMu, and that there were problems with WaMu personnel calling appraisers directly.  
9 In addition, CW 42 also dealt with systematic requests from WaMu for ROVs. Indeed, CW 42's  
10 group at LSI handled "a ton of reviews" requested by WaMu.

11           285. CW 42 explained that, concerning ROV requests from WaMu, if WaMu was  
12 unhappy with the value initially appraised, the appraisal report was returned to the original  
13 appraiser. If the original appraiser did not change the value to a higher value acceptable to  
14 WaMu, then the appraisal could be sent to a different appraiser. According to CW 42, the new  
15 appraiser would not go out to the subject property again; he would merely review the appraisal  
16 report.

17           286. CW 42 also explained that if an appraiser hired on behalf of WaMu refused to  
18 increase an appraisal value, the appraiser would have to provide very good documentation  
19 justifying this refusal and submit a letter explaining his reasoning. Thus, explained CW 42, most  
20 of the time when pressured by WaMu, the appraisers agreed to increase appraisal values.

21           287. In fact, according to CW 42, appraisers hired on behalf of WaMu routinely would  
22 accede to increases in value of at least \$5,000-10,000 when pressured by WaMu. CW 42 also  
23  
24  
25  
26  
27

1 observed that there were “ways around a lot of different things out there” that could be used to  
2 create much larger increases in appraisal values as well.

3 288. CW 43, an Appraisal Services Representative for LSI’s WaMu team in 2006,  
4 observed first hand that WaMu would solicit repeat appraisals and ROVs from LSI when the first  
5 appraisal did not provide WaMu with the property value it sought. CW 43 noted that WaMu  
6 would pursue its request to increase value with the first appraiser, or subsequent appraisers if  
7 necessary, until WaMu got the “value necessary to make the loan.” According to CW 43, most of  
8 the time, a second appraiser would give in and provide WaMu an appraisal reflecting the  
9 property value it desired. CW 43 commented, with respect to WaMu’s use of “preferred  
10 appraisers,” that she found it “strange” and “wrong” that WaMu used its own designated  
11 appraisers instead of “an independent party.”  
12

13 289. CW 44, who served as a Customer Service Specialist at LSI in 2006 and who  
14 serviced WaMu, also stated that WaMu loan consultants regularly called him to complain about  
15 LSI appraisals coming in at values lower than they desired.  
16

17 290. CW 45 worked in LSI Client Services from November 2006 through December  
18 31, 2007. While at LSI, CW 45 served on both the Bank of America and the WaMu teams.

19 291. From November 2007 until he left the company, CW 45 handled ROVs requested  
20 by WaMu. CW 45 was transferred to the WaMu team after LSI experienced a spike in business  
21 from WaMu after what CW 45 described as the “incident” with eAppraiseIT, referring to the  
22 filing of the NYAG Complaint.  
23

24 292. According to CW 45, there was a huge amount of pressure from WaMu on  
25 appraisers to “bring in values.”  
26  
27

1           293. CW 45 confirmed that WaMu caused LSI to use only appraisers from a “preferred  
2 appraiser” list for WaMu appraisals. CW 45 did not know of any “preferred appraisers” that did  
3 not have a prior relationship with WaMu. Therefore, CW 45 concluded that the “preferred  
4 appraiser” list was, in effect, a way for WaMu to select its appraiser, albeit through LSI as a  
5 “middleman,” since any appraiser on the “preferred” list was pre-selected by WaMu.  
6

7           294. CW 45 explained that if the value on an appraisal did not “come in” at the value  
8 WaMu desired, WaMu could request an ROV and send in additional comps. The loan file would  
9 then be returned to the original appraiser, who would determine whether a value increase was  
10 warranted. CW 45 stated that appraisers typically said that they could not use someone else’s  
11 comps and needed to use their own, but they would be pressured to consider the comps provided  
12 by WaMu. According to CW 45, WaMu sometimes requested ROVs on a single property 3 or 4  
13 times if WaMu was dissatisfied with the true appraisal value.  
14

15           295. CW 45 further stated that although WaMu should have handled everything  
16 relating to appraisals with LSI through the customer service department, WaMu instead would  
17 often contact appraisers directly – something CW 45 called a “common practice” by WaMu. By  
18 way of example, CW 45 explained that CW 45 would call an appraiser to discuss the status of a  
19 WaMu ROV, and the appraiser would mention that he had already spoken with the WaMu loan  
20 officer or already had received the new comps.  
21

22           296. CW 45 also stated that if WaMu could not succeed in pressuring an appraiser to  
23 increase value, WaMu would often then try to switch to a different appraiser in hopes of getting  
24 the value WaMu wanted, or would request a different type of appraisal, such as a less-  
25 comprehensive “desk” or “filed” review.  
26  
27

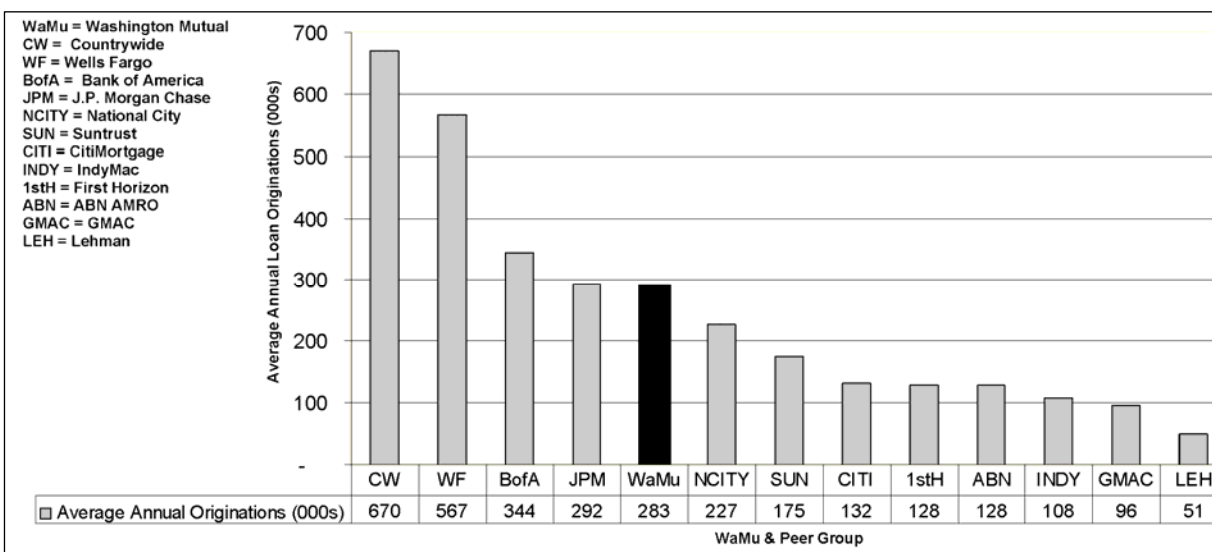
297. In addition, CW 45 stated that when WaMu transferred more business to LSI in response to the NYAG complaint, LSI received outstanding ROVs that WaMu had pending with eAppraiseIT. According to CW 45, WaMu simply brought all the eAppraiseIT ROVS over to LSI when WaMu severed ties with eAppraiseIT. Moreover, CW 45 observed that WaMu ordered ROVs from LSI on appraisals that had been conducted by eAppraiseIT. CW 45 could not comprehend how LSI ROVs on files transferred from eAppraiseIT were still considered ROVs since LSI did not perform the original appraisal, but they were handled as such. In other words, WaMu required LSI to perform ROVs on any appraisals that had been performed by eAppraiseIT to try to increase the value of those loans, even though WaMu knew that eAppraiseIT had been sued by the New York Attorney General for inflating appraisal values.

**e. Expert Analysis of Relevant Housing Data  
Also Evidences WaMu's Improper  
Appraisal Inflation During the Class  
Period**

298. Lead Plaintiff's investigation of WaMu's lending practices includes the analysis of vast amounts of raw data collected about WaMu and other lenders that reveals WaMu's lending practices compared to those of its peer lending companies (the "Peer Group"). Lead Counsel retained experts in the field of banking regulation and mortgage finance to analyze data produced by WaMu and its Peer Group to the U.S. Department of Housing & Urban Development pursuant to the Home Mortgage Disclosure Act (defined above as "HMDA"). The complex analysis undertaken on behalf of Lead Plaintiff required the use of mainframe computer systems and custom programming by experts to compile and analyze over ten gigabytes of data consisting of millions of observations of raw HMDA data pertaining to every loan originated by WaMu and the Peer Group from 2005 through 2007. This amount of data would constitute over 1.3 million pages if it were produced in paper form.

299. To identify WaMu's Peer Group, Lead Plaintiff's experts determined the top lenders by lending volume in the United States for each calendar year from 2005 through 2007. These lenders compare directly and fairly to WaMu in that they have a national footprint for originating home mortgage loans and produce similar volumes of prime loans. The Peer Group includes twelve other lending institutions such as Bank of America, Chase Manhattan, Countrywide, Indymac, and JP Morgan Chase. Chart 2 below identifies each of the members of the Peer Group, along with the average number of loans originated per year by each of WaMu's peers.

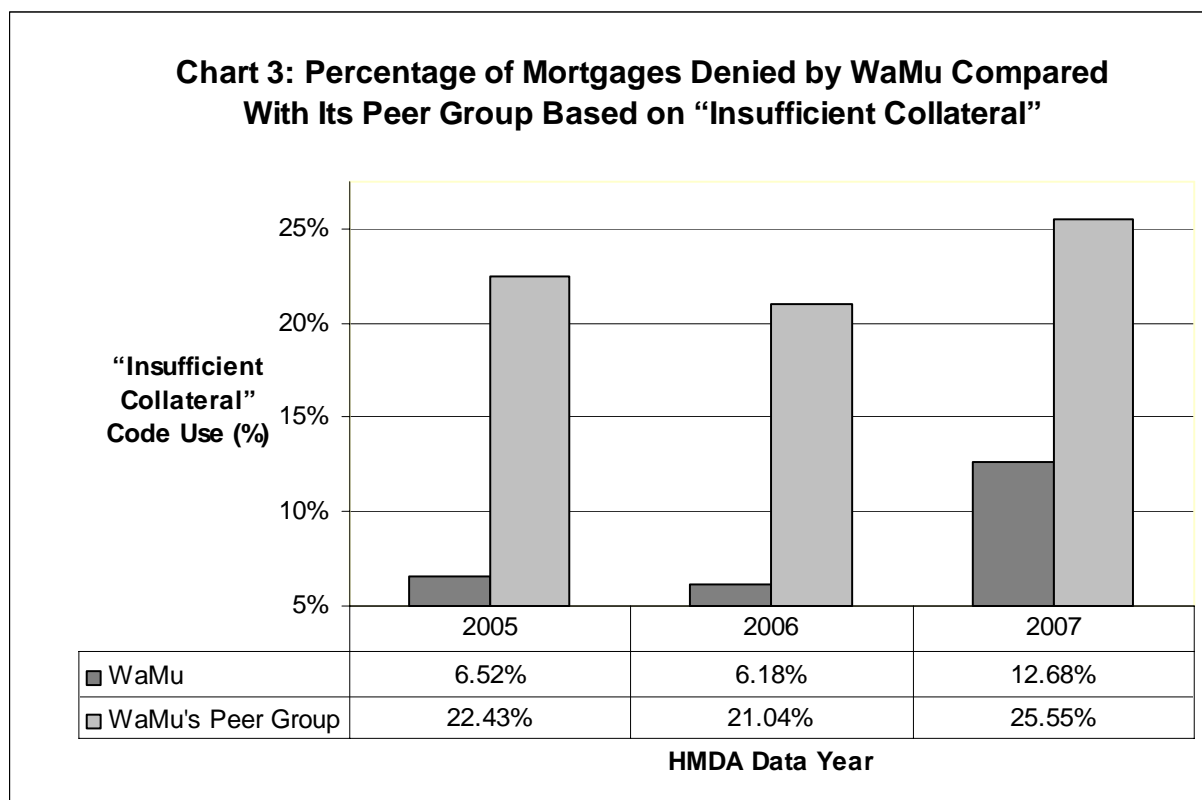
**Chart 2: Average Annual Loan Originations  
WaMu and Peer Group**



300. Lead Plaintiff's experts then analyzed WaMu's lending practices compared to its Peer Group utilizing the HMDA data. Specifically, mortgage lenders are required in their HMDA reports to reveal the basis for their denial of loan applications. These reasons for denial take the form of nine "denial codes": (1) insufficient collateral; (2) debt-to-income ratio; (3) employment history; (4) credit history; (5) insufficient cash; (6) unverifiable information; (7) credit application incomplete; (8) mortgage insurance denied, and; (9) "other." Insufficient

collateral is another way of saying that the appraisal of the home at issue did not hit a level sufficiently high to justify the requested mortgage.

301. This analysis of HMDA data reflected in Chart 3, below, further corroborates other aspects of Lead Plaintiff's investigation set forth herein related to the Officer Defendants' pervasive manipulation of appraisals to increase appraisal values related to WaMu loans. Indeed, the chart below shows that, on a nationwide basis, appraisal values created much less of a barrier to extending credit for WaMu than it did to WaMu's Peer Group: WaMu denied loans based upon "insufficient collateral" at a significantly lower rate than WaMu's Peer Group did throughout the Class Period.



302. The data summarized above is the result of a thorough analysis of the enormous volume of HMDA data concerning loan application denials for one-to-four family residences. This annual HMDA data set consisted of millions of loan denials. Lead Plaintiff's experts



1 eliminated from consideration any declined loan where the lenders failed to offer a denial code,  
2 leaving only those loans where at least one denial code was used. If “collateral” is shown as a  
3 reason for denial, then that loan was recorded as declined based on insufficient collateral for the  
4 loan which is directly correlated to the value reflected in the property appraisal. That is, if a  
5 property appraises at a value too low for the loan in question, then the “collateral” denial code is  
6 used.  
7

8 303. Because, as explained above, one of the denial codes is “credit application  
9 incomplete,” Lead Plaintiff’s experts refined their analysis and findings to control for this  
10 potential bias, which exists because an appraisal is unlikely to be requested (and paid for) if a  
11 borrower’s credit application is incomplete. To determine whether this bias affected the above  
12 findings, Lead Plaintiff’s experts re-analyzed the HMDA data without any loan data included  
13 that registered “credit application incomplete” in any of the three denial code fields.  
14

15 304. Also, since the HMDA data contains information on the state, county, and census  
16 tract level as Federal Information Processing Standards (FIPS) codes, Lead Plaintiff’s experts  
17 took the additional step of only comparing WaMu denials to those of its Peer Group in the same  
18 census tract. By way of background, there are more than 65,000 census tracts in the United  
19 States. The size of a census tract varies by population; in a large urban area like Seattle, a census  
20 tract may be the size of only a few city blocks. In order to produce a robust analysis, Lead  
21 Plaintiff’s experts used data only from those census tracts where there were at least six loan  
22 denials from WaMu and six loan denials from the Peer Group in a single census tract.  
23

24 305. Finally, in the interests of producing a fair representation of these findings, Lead  
25 Plaintiff’s experts weighted each census-tract level difference by the number of loans WaMu  
26 declined in that census tract. Thus, for those census tracts where WaMu denied twenty loans,  
27

1 that census tract is given greater weight in the result than a census tract where WaMu made only  
2 six loan denials. In so doing, Lead Plaintiff's experts were able to create a weighted-difference  
3 analysis between WaMu and its Peer Group, reducing volatility in the findings by (a) controlling  
4 for the volume of lending done both by WaMu and its Peer Group in a census tract; (b) using  
5 only those census tracts in which WaMu and its Peer Group denied at least six loan applications  
6 each; and (c) weighting the resulting differences by the WaMu denial count in each census tract  
7 so that differences between geographical areas are fairly represented.  
8

9 306. In sum, the analysis of relevant HMDA data undertaken on behalf of the Lead  
10 Plaintiff clearly reveals that, on a census tract by census tract basis, for each year of the Class  
11 Period, appraisal values posed little hurdle for WaMu to originate loans compared to its peer  
12 lenders. Consistent with the other facts discussed above and throughout this Complaint, this  
13 analysis (based on raw data from WaMu and its peers) shows that WaMu was obtaining more  
14 favorable appraisals, and was thus less constrained in offering large volumes of loans, when  
15 compared with WaMu's Peer Group during the Class Period.  
16

17 **D. WaMu's Underwriting Standards Were**  
18 **Secretly Weakened at Defendants' Direction**

19 307. Unbeknownst to the members of the Class, the Officer Defendants caused  
20 WaMu's underwriting standards to significantly deteriorate during the Class Period. In fact, the  
21 Officer Defendants created a false and misleading appearance of restrictive, quality-focused  
22 underwriting at WaMu through their many public statements.

23 308. As explained above, underwriting is a critical component of every loan, because it  
24 acts as a form of quality control by which the loan originator is able to enforce its policies for  
25 approving or disapproving loans pursuant to its guidelines. Throughout the Class Period, WaMu  
26  
27

1 did not disclose the specifics of its underwriting guidelines to the investing public, but instead  
2 treated such information as proprietary.

3         309. Nevertheless, as discussed in Section VIII, the Officer Defendants regularly  
4 discussed WaMu's purportedly strong underwriting standards in public filings, earnings calls,  
5 and investor conferences. In particular, Defendants misrepresented that the Company's  
6 underwriting for its "prime" loans was uniformly strong and that the Company took great care to  
7 confirm the credit-worthiness of its Option ARM and subprime borrowers. For example, in the  
8 Company's 2005 and 2006 Forms 10-K, the Company stated: "[t]he Company seeks to mitigate  
9 the credit risk in this portfolio by ensuring compliance with underwriting standards on loans  
10 originated to subprime borrowers and by re-underwriting all purchased subprime loans."  
11 Similarly, in speaking of the Company's Option ARM portfolio, the Officer Defendants claimed  
12 that "The Company actively manages the credit risk inherent in its Option ARM portfolio  
13 primarily by ensuring compliance with its underwriting standards, monitoring loan performance  
14 and conducting risk modeling procedures." The Officer Defendants repeatedly stated that  
15 "[c]redit quality continues to surpass [the Officer Defendants'] expectations," that the Company  
16 maintained "disciplined credit underwriting," that "on the credit front, we continue to be in  
17 excellent shape," and that the Company's "credit quality remains strong."

18         310. Indeed, throughout the Class Period, WaMu touted the fact that it supposedly  
19 adhered to so-called "Responsible Residential Lending Principles" that WaMu had formulated in  
20 2001. These Principles, which WaMu distributed publicly through its website and other media,  
21 announced that WaMu "is committed to . . . setting the highest standards for responsible  
22 lending." One of the first Principles set forth by WaMu was that WaMu purportedly "*only*  
23 *extend[s] credit to borrowers who have demonstrated to us the ability to repay the loan.*"  
24  
25  
26  
27

311. As detailed below, numerous former WaMu employees with direct knowledge of WaMu's underwriting policies and practices and WaMu management's involvement in establishing such policies and practices confirm that, unbeknownst to investors, with the Officer Defendants' knowledge or reckless disregard, WaMu abandoned appropriate and asserted underwriting standards for its loans in favor of underwriting policies designed to allow WaMu to increase the volume of loans it could originate and therefore inflate the Company's earnings.

**1. Underwriting Standards for WaMu's  
"Prime" Loans Were Deficient**

312. The Officer Defendants consistently emphasized to the public that the Company's "prime" loans were of "high quality" and attributed any of the Company's credit problems to the Company's subprime channel. For example, at the Company's 2006 Investor Day held in September 2006, Defendant Cathcart claimed the Company had "maintained conservative lending standards" in the Company's prime and home equity portfolios that resulted in "high quality loans."

313. However, as shown below based on numerous detailed reports from former WaMu employees who had direct, contemporaneous knowledge of the Company's actual underwriting practices, the Company's inappropriately sales-driven underwriting pervaded its home loans product line – not just its subprime loans, but also WaMu's so-called "prime" loans.

**a. WaMu's "Prime" Loans Were  
of Lesser Quality than WaMu Disclosed**

314. During the Class Period, WaMu made regular public statements distinguishing between WaMu's "prime" and "subprime" loans. For example, the Company periodically reported its volumes of prime and subprime mortgage loans produced and sold, the volumes of

1 prime and subprime loans held for investment, and the value of the Company's credit-sensitive  
2 retained (or "residual") interests in securitized prime and subprime loans.

3 315. However, Defendants' statements that purported to distinguish between WaMu's  
4 "prime" and "subprime" loans were false and misleading because WaMu, during the Class  
5 Period, did not adhere to industry standards for classifying loans, although Defendants'  
6 statements on such matters created the false impression that WaMu had followed strict  
7 underwriting guidelines for its "prime" loans and therefore originated and held "prime" loans  
8 that were of high quality.

10 316. In the mortgage and consumer lending industry, the most widely accepted  
11 measure of borrower creditworthiness is the borrower's Fair Issac Credit Organization ("FICO")  
12 credit score. According to FICO, most lenders base loan approval on the credit score of the  
13 borrower; it is "the industry's most trusted source."

15 317. FICO scores are key determinants of whether a given borrower will be classified  
16 as "prime" or "subprime." FICO is the most commonly used credit score and during the Class  
17 Period, Fitch Ratings termed FICO scores the "best single indicator" of mortgage default risk. In  
18 fact, in its 2005 Amended Form 10-K among other class period filings, WaMu describes credit  
19 scores as "a useful measure for assessing the credit quality of a borrower." The Company further  
20 states that the credit score is one of two key determinants "in forecasting future loan  
21 performance." As explained above in Section VI.C, WaMu stated that the other "key  
22 determinant" in forecasting future loan performance is the loan's LTV ratio.

24 318. A FICO score can range from 300 to 850 and is calculated based on payment  
25 history, amounts owed to creditors, length of credit history, new credit sources, and types of  
26 credit used. Generally, the higher the FICO score, the better the borrower's credit and the lower  
27

1 the risk of default. According to Fair Isaac, approximately 27% of the U.S. population has a  
2 FICO score between 750 and 799, 27% has a score below 650, and 15% has a score below 600.

3 319. According to the Expanded Guidance for Subprime Lending Programs, issued  
4 jointly by the Officer of the Comptroller for Currency, the Federal Reserve Board, the Federal  
5 Deposit Insurance Corporation and the Officer of Thrift Supervision on February 2, 2001,  
6 subprime borrowers generally have a FICO score of 660 or below. This Expanded Guidance was  
7 sent to CEOs such as WaMu CEO Defendant Killinger by both the FDIC and the OTS. The  
8 Expanded Guidance lists various credit characteristics of subprime borrowers, including:  
9 payment delinquencies, charge-offs, judgments and bankruptcies. Such borrowers “may also  
10 display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other  
11 criteria that may encompass borrowers with incomplete credit histories.” As expressly pointed  
12 out in the guidance, subprime loans “have a higher risk of default than loans to prime  
13 borrowers.” The Expanded Guidance states that loans should be classified as subprime in  
14 accordance with the guidelines and other applicable Agency guidelines.  
15  
16

17 320. Standard & Poor’s, one of the leading securities rating agencies and self-  
18 proclaimed “single authoritative source of unbiased equity analysis and opinion” states that it  
19 considers “prime borrowers to have a FICO credit score of 660 or above.”  
20

21 321. Freddie Mac, a GSE, issues a Single-Family Seller/Servicer Guide which states  
22 that “FICO scores are an effective tool in evaluating a Borrower’s credit reputation . . . Freddie  
23 Mac has identified a strong correlation between Mortgage performance and FICO scores.” For  
24 single-family homes, Freddie Mac views a FICO score of 660 or above as “likely to have an  
25 acceptable credit reputation.” A FICO score of 620 to 660 is viewed as “an indication that the  
26 Borrower’s willingness to repay and ability to manage obligations as agreed are uncertain.” A  
27

1 FICO score of below 620 “should be viewed as a strong indication that the Borrower’s credit  
2 reputation is not acceptable[.]”

3 322. Throughout the Class Period, Washington Mutual publicly stated that its prime  
4 loan borrowers had high FICO scores. For example, during WaMu’s 2006 Investor Day  
5 Conference held on September 7, 2006, Defendant Cathcart stated that the home equity portfolio,  
6 primarily generated through retail banking channels, has an average FICO score at origination of  
7 734. Defendant Cathcart also commented on the Option ARM loan product, which he said is  
8 “not made available to subprime borrowers,” stating that the portfolio has a weighted average  
9 FICO score of 708.  
10

11 323. WaMu’s claims of high FICO scores for its prime home equity portfolio and  
12 Option ARMs continued throughout 2006 and 2007. During the Lehman Brothers 10th Annual  
13 Financial Services Conference on May 16, 2007, Defendant Killinger reported that the prime  
14 residential portfolio, two-thirds of which is Option ARM loans, has an average FICO score of  
15 708. The Option ARM customers are reported to have an average FICO score of 700.  
16

17 324. But, according to confidential witnesses who worked for WaMu at the time, those  
18 publicly-reported FICO scores were not correct or were misleading at best. In fact, CW 46, who  
19 was a Loan Consultant for WaMu in New York from 2003 to 2006, stated that during the Class  
20 Period, borrowers with credit scores as low as 540 were approved for “prime” loans. Other  
21 witnesses have also confirmed that WaMu’s so-called “prime” loans often were to borrowers  
22 with subprime FICO scores.  
23

24 325. CW 47 worked with WaMu from 1997 to February 2008. From late 2005 until  
25 February 2008, CW 47 worked for WaMu as a Negotiated Transaction Manager in South Florida.  
26  
27

1 During 2004 through 2005, CW 47 served as a Credit Quality Manager and an Area  
2 Underwriting Manager responsible for the east coast.

3 326. According to CW 47, WaMu made regular “FICO exceptions” on Option ARM  
4 loans, a supposedly “prime” product. CW 47 stated that until the summer of 2007, a borrower  
5 could receive a low-documentation Option ARM loan from WaMu with a 620 FICO score. In  
6 fact, CW 47 recalls a meeting in 2003 with the former Home Loans Chief Credit Officer Mark  
7 Hillis during which Hillis predicted that, within five years, 85% of WaMu ARM borrowers  
8 would not be able to afford their mortgage.

10 327. Similarly, CW 2 worked for WaMu from 2005 to February 2008 as an  
11 Underwriting Supervisor. CW 2 also held several positions with the Company from 1995 to  
12 2005 including Senior Credit Analyst Officer, Senior Loan Coordinator and Telephone Banker.  
13 According to CW 2, beginning in 2005, WaMu lowered the required FICO score on prime loans.  
14 While before 2005, a FICO score of around 700 was required, between 2005 and 2007 the  
15 minimum FICO score requirement was 620 – 40 points below the recognized threshold between  
16 prime and subprime borrowers.

18 328. Through Lead Plaintiff’s investigation, Lead Plaintiff has obtained a training  
19 document for subprime loan production employees that was revised and updated in September  
20 2007. The document is a WaMu PowerPoint presentation entitled “Specialty Lending UW  
21 [Underwriter] HLCA [Home Loans Credit Authority] Training,” revised September 26, 2007. In  
22 the training document, WaMu explains which loan applications are eligible for “specialty lending  
23 consideration,” (*i.e.*, subprime) as opposed to being considered a prime loan. The presentation  
24 makes clear that, regardless of borrowers’ credit history or actual potential to repay a loan, if the  
25  
26  
27



1 borrower WaMu targets for one of its “prime” loans has a FICO score over 619, that borrower  
2 would be considered a “prime” borrower.

3 329. In one stunning example, the Company instructed in an internal WaMu document  
4 to its underwriters during the Class Period that if a borrower applies for a “5/1 Amortizing ARM”  
5 and the borrower had a bankruptcy “less than 4 years ago,” but has a FICO score of 621, WaMu  
6 will consider that borrower prime. Even with a recent bankruptcy and a weak FICO score,  
7 WaMu would classify such borrowers as “prime” based on its loose guidelines and to the  
8 exclusion of any other credit risk considerations (as explained above, a borrower with a FICO  
9 score below 660 is typically considered a subprime lender).  
10

11 **b. WaMu’s Underwriting Standards for Its**  
12 **So-Called “Prime” Loans Were**  
13 **Irresponsibly Permissive**

14 330. Highly experienced mortgage underwriters who worked at WaMu during the  
15 Class Period were shocked by how lenient WaMu was in its lending. Confidential Witness 48  
16 was a Senior Underwriter in the Washington Mutual Wholesale loan fulfillment center in Lake  
17 Success, New York, from June 2005 through February 2008. CW 48 had twenty-plus years of  
18 experience underwriting home loans, beginning at Chemical Bank and moving on to Chase and  
19 Wells Fargo before joining WaMu in June 2005. When CW 48 arrived at WaMu, CW 48 was  
20 stunned to find that WaMu’s supposedly “A paper” (*i.e.*, prime loans) consisted of loans made to  
21 borrowers with credit scores in the 500s, high LTV ratios, and Option ARM loans. CW 48  
22 reported that there was “only so much you could do” with the loans she underwrote, because  
23 they met WaMu’s lenient underwriting guidelines and CW 48 did not want to discriminate  
24 among borrowers by denying loans to some borrowers who met WaMu’s loose guidelines merely  
25 because CW 48 did not think that borrower could actually repay the loan that WaMu had sold.  
26  
27

1           331. Similarly, Confidential Witness 49 was appalled by the lenient standards in place  
2 at WaMu. CW 49 served as a Senior Underwriter with WaMu through a private mortgage  
3 insurance company. CW 49 reported that WaMu's reputation in the mortgage industry was that  
4 "if you had a pulse, WaMu would give you a loan." CW 49 stated that the underwriting  
5 guidelines at WaMu "changed every minute. . . . You would literally be getting an email every  
6 second that the guidelines changed or would have a pissed off account executive at your desk  
7 asking why the loan can't go through." Often, CW 49 reported, loans would be taken away from  
8 her to be approved by another underwriter who was not as conscientious. CW 49 often saw  
9 active or approved loans in the system that CW 49 had refused to underwrite and were ultimately  
10 signed off on by someone else. According to CW 49, "They would give it to one of their 'lead  
11 underwriters' to approve."

12  
13           332. Before the loan came to CW 49's desk, it could be automatically underwritten  
14 through a computer program, modeled after Fannie Mae's "Desktop Underwriter" ("DU")  
15 program. CW 49 explained that while anything outside of these guidelines would require a  
16 manual underwriting process, loans that could be underwritten using the DU system could be  
17 approved by a loan processor without any involvement from an underwriter. CW 49 recalled that  
18 regularly, if a loan was rejected by the computer, the loan consultant would repeatedly re-enter  
19 the loan's information, changing the information a little each time, "tweak[ing] the system."

20  
21           333. Confidential Witness 50, who served as a Loan Consultant with WaMu from 2001  
22 to 2007, recalled that in 2005 WaMu's underwriting guidelines loosened dramatically,  
23 particularly with regard to Option ARM loans. CW 50 experienced that as WaMu "pushed"  
24 Option ARM loans, "[a]nyone got approved for [Option ARMs]." Indeed, according to CW 50,  
25 WaMu's underwriting standards for Option ARM loans were among its most lenient.  
26  
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1 334. CW 9, who, as noted above, served as a Senior Loan Coordinator with WaMu  
2 from 1998 through 2007, explained that exceptions to the underwriting guidelines were made  
3 often during the Class Period. CW 9 recalled, "I saw underwriting managers and other managers  
4 waive a lot [of supposed underwriting rules]." According to CW 9, everyone in the branch felt  
5 pressure from WaMu management to close loans. "Once a week you'd go in with your manager,  
6 [and he'd say] 'why didn't this loan close, why didn't that one close?'" CW 9 said the pressure  
7 "was coming from the very top, the managers had to listen to the head manager, who had to  
8 listen to corporate." CW 9 added, "I almost had a nervous breakdown."

10 335. According to CW 9, the underwriting guidelines were "constantly changing" and  
11 there were "a lot of them. Over the last year, when we were booming, [the guidelines] changed a  
12 lot." The underwriting procedures progressively loosened and "got really bad in 2006." WaMu's  
13 "top priority was to get as many loans closed as quickly as they could close and not worry – they  
14 just wanted the volume, and it didn't seem to matter how they got it." CW 9 felt that WaMu  
15 employees were "greedy" and that the borrowers suffered as a result. CW 9 concluded, "[w]e  
16 could never figure it out why people came to us [for loans]."

18 336. Various witnesses with direct experience in WaMu's prime underwriting  
19 operations have explained that during the Class Period, exceptions to WaMu's stated, already low  
20 prime underwriting guidelines were the rule.

22 337. As observed by CW 2, who worked for WaMu from 1995 through 2008, most  
23 recently as a Assistant Vice President Credit Level 3, Underwriting Supervisor, no exception to  
24 the underwriting guidelines was needed for many questionable loans, because WaMu's  
25 "guidelines were so generous." However, for those loans that did not fit within the loose  
26 guidelines of WaMu's underwriting standards, exceptions were encouraged and readily available.

1           338. Indeed, Confidential Witness 51, a Senior Underwriter at the WaMu home loan  
2 center in Lake Success, New York from 2007 to 2008, stated that guideline exceptions were “part  
3 of the norm . . . it was so commonplace to go outside of the guidelines.” Even when  
4 underwriting exceptions were sent to management for approval, CW 51 observed, the exceptions  
5 “were always approved, so it was just business as usual and something that they were  
6 comfortable with.”  
7

8           339. Confidential Witness 5, who was a Senior Credit Quality Manager with WaMu  
9 from March 2005 through February 2008, observed that the true problem with the credit quality  
10 of WaMu’s “prime” loans was that WaMu’s prime underwriting “standards” were actually  
11 viewed by WaMu as little more than suggested guidelines: WaMu’s loan consultants were  
12 encouraged by WaMu to obtain exceptions to the underwriting guidelines throughout the  
13 Company whenever necessary to close more loans.  
14

15           340. Confidential Witness 52, an underwriting Team Manager with WaMu from 2004  
16 through 2007, was in charge of working through loan problems with more junior underwriters  
17 when they could not resolve the issue on their own. CW 52 could authorize an exception or  
18 escalate underwriting issues up to management. CW 52 estimated that exceptions to the  
19 underwriting guidelines occurred 30-40% of the time. According to CW 52, the types of  
20 exceptions “varied so much” from “accepting certain income documentation – or lack thereof –  
21 to credit score exceptions . . . there [were] tons of exceptions.”  
22

23           341. Confidential Witness 53, a Senior Loan Processor in Pittsburgh from 2004  
24 through 2006 and again in 2007, agreed that WaMu’s loans were exception-ridden: “You could  
25 pretty much get an exception on any loan you wanted to.” If CW 53 did not agree that the  
26 appropriate conditions to approve a loan were met, CW 53 would send the loan back to the  
27

1 underwriter. If the underwriter did not accept the loan, “usually” the in-house managers would  
2 accept the loan. Occasionally, particularly problematic loans would be escalated to upper  
3 management. According to CW 53, in those cases, WaMu management would approve it  
4 because WaMu management “just wanted to get loans through, close loans. It didn’t matter if the  
5 loan was good or it wasn’t good.”

6  
7 342. As discussed further above, Confidential Witness 47 was a long-time WaMu  
8 employee whose final position with the Company was as a Negotiated Transaction Manager. As  
9 a Negotiated Transaction Manager, CW 47 was one of four senior underwriters with the  
10 Company charged with approving exceptions to WaMu underwriting guidelines for loans greater  
11 than \$3 million and exceptions beyond those that WaMu underwriting managers were allowed to  
12 make. CW 47 relayed that she and others in her position at WaMu were required to make  
13 numerous exceptions to WaMu’s stated underwriting guidelines. Indeed, CW 47 stated that the  
14 Negotiated Transaction Managers would be under a great deal of pressure to approve certain  
15 loans, especially where loan consultants had “important relationships.” Those loans for which  
16 CW 47 and the other Negotiated Transaction Managers refused to make exceptions, even after  
17 being pressured, were referred up WaMu’s chain of command to Mark Brown, National  
18 Underwriting Manager, or Cheryl Feltgen, Division Executive Chief Risk Officer for approval  
19 where, as CW 53 described, the exception ridden loans would readily be approved. In this  
20 regard, CW 47 said, WaMu was willing to make greater FICO exceptions on Option ARM loans  
21 than on fixed rate loans.  
22  
23

24 343. Confidential Witness 11 confirmed the widespread use of underwriting exceptions  
25 at WaMu. According to CW 11, a former Senior Loan Coordinator who was responsible for  
26 evaluating the acceptability of loan applications at WaMu from November 2006 to mid-2007,  
27

1 “[w]e used to make exceptions that were not justified.” CW 11 recalled that some WaMu loan  
2 originators were able to generate “huge amounts of loans” by making exceptions to underwriting  
3 guidelines.

4 344. Confidential Witness 54 further confirmed that the Company’s “prime” loans had  
5 significant credit problems inherent in their underwriting. CW 54 spent over seven years with  
6 WaMu, most recently serving as a Credit Risk Supervisor in Jacksonville, Florida from 2004  
7 until March 2007. As a Credit Risk Supervisor, CW 54 managed sixteen people involved in the  
8 auditing of post-closed loans, which involved the analysis and validation of credit and additional  
9 information processed through each of the loan processing centers, acting as a “validation of the  
10 front-end process.” CW 54 explained that the credit risk area consisted of approximately sixty-  
11 eight individuals who reviewed a random sample size of 10% of all loans underwritten  
12 throughout each of the WaMu loan processing centers. They were not involved in any analysis  
13 of loans pertaining to LBM or any loans acquired by WaMu from third-party lenders. CW 54  
14 remembers that all loans that she were analyzed were “prime.”  
15

16 345. Through the use of an internal system program called “END,” 10% of the loans  
17 from each loan processing center were selected for review on a monthly basis, and they would  
18 validate the specific information pertaining to each individual loan. CW 54 was surprised by the  
19 many loans that were approved, yet were ultimately identified by the group as “problem loans.”  
20 While the loans were designated as prime, the audit would routinely find information suggesting  
21 that there were significant credit issues with various loans. For example, CW 54 indicates that  
22 while the loan files might designate high credit scores, the audit would routinely identify  
23 borrowers that did not maintain the credit worthiness to qualify for the loans that they had  
24 already been approved, such as borrowers with credit scores as low as 525. Those types of errors  
25  
26  
27

1 were constantly being identified by the auditing group, which would subsequently forward those  
2 problem loans to either the risk mitigation or risk management departments. CW 54 recalled that  
3 WaMu senior management, including Cheryl Feltgen, Chief Credit Officer for the Home Loans  
4 Group, received and reviewed this information.

5  
6 346. One of the primary causes for the errors located by CW 54's group was that  
7 WaMu underwriters relied heavily upon the Company's "Optis" system, which was an internal  
8 "auto-approve" program that allowed many loans to be approved without any significant level of  
9 due diligence on the borrowers. CW 54 pointed out that the purpose of Optis was simply to  
10 make it easier to approve a higher volume of loans, rather than to perform a thorough due  
11 diligence on each borrower.

12  
13 347. According to CW 29, a WaMu underwriter in Portland Oregon from 2002 through  
14 2006, WaMu's biggest problems were ARM products and stated-income loans. CW 29 explained  
15 that even when "borrowers were simply not qualified," WaMu's loose underwriting guidelines  
16 allowed borrowers to meet stated-income loan guidelines because of their credit scores. For  
17 example, CW 29 recalled multiple times where underwriters wanted to lower the stated income  
18 on the loan application, based on an evaluation of the borrower's actual circumstances, but  
19 WaMu would not allow such revisions. CW 29 reported, "It seemed that with any stated  
20 [income] loan, \$5,000 was the magic number that loan consultants would put on applications as  
21 monthly income. It got to be a joke after a while." As a result, CW 29 said that stated income  
22 loans were commonly referred to at WaMu as "lie-to-me loans."

23  
24 348. In addition, with regard to stated-income loans, during CW 29's tenure at WaMu,  
25 the Company began to accept a job description in lieu of proof of employment. Underwriters  
26 objected to this practice because a job description is not sufficient proof that a person is  
27



1 employed and holds that position. CW 29 recalled that the borrower's job description did not  
2 even have to be produced by the borrower's employer or have to be on their employer's  
3 letterhead: "it was sufficient to print out a job description found online." Thus, in addition to  
4 allowing borrowers to state their income without being required to show any proof, according to  
5 CW 29, WaMu similarly allowed borrowers to state their employment without requiring any  
6 further verification.  
7

8 349. Regarding the problems WaMu began to have with loan losses, according to CW  
9 29, "all the underwriters we have here in town have a joke: We laugh and say it was all those 'lie  
10 to me loans' that were done." CW 29 explained, "[w]e knew it was all the loans we did that we  
11 would see foreclosures on."

12 350. Confidential Witness 8 also found WaMu's policy of offering "stated-income"  
13 loans particularly troublesome. According to CW 8, WaMu began to issue more stated income  
14 loans in 2006 and 2007. CW 8 recalled that "Ten or fifteen years ago, a stated income loan was  
15 called a 'liar's loan' by Fannie Mae. Then they brought it back." CW 8 said that often on stated  
16 income loans, there was "no due diligence to verify income." Depending on the borrower's FICO  
17 score, WaMu may not ask to see any additional information. "If there was someone with a great  
18 FICO score, they didn't ask for anything else. Sometimes the FICO score and the appraisal were  
19 the only things they looked at." CW 8 saw an "increase in early payment defaults" that CW 8  
20 attributed to WaMu making loans to borrowers who "were qualified for something on a stated  
21 income that they couldn't pay for."  
22  
23

24 351. Confidential Witness 55 worked for WaMu as a Senior Underwriter for non-  
25 prime loans from October 2003 to May 2007 and as an underwriter for prime loans from October  
26 2007 to March 2008. CW 55 stated that 100% stated-income loans were the biggest product for  
27



1 the Company. Even 100% stated-income loan files where CW 55 found fraud were “pushed  
2 through” by WaMu management. For instance, CW 55 found loan applications containing  
3 fraudulent W-2s, letters purporting to state income, bank statements and business licenses, but  
4 WaMu managers would still approve the loans even after being advised that borrower  
5 documentation was not in order.

6  
7 352. Confidential Witness 56, who was a Retail Bank Loan Underwriter in Pleasanton,  
8 California from 2007 to April 2008, experienced that WaMu’s underwriting guidelines were  
9 “really loose” and “anyone could get a loan.” CW 56 compared her experience at WaMu with  
10 CW 56’s prior employment at Countrywide Bank, recalling that Countrywide had standards  
11 mandating, for example, that a borrower possess a debt-to-income ratio (“DTI”) of 38 to 40  
12 percent. In contrast, CW 56 recalled, “WaMu let you go up to 65 or 67 percent DTI.”

13  
14 353. Furthermore, WaMu often designated loans as “fully documented” when, in fact,  
15 the loans had limited to no documentation of income or assets. Confidential Witness 57 was a  
16 Trader in WaMu’s Capital Markets Group in Seattle, Washington from 2002 until October 2007.  
17 CW 57 was responsible for coordinating sales of Alt-A loans originated by WaMu to the  
18 secondary market. CW 57 managed the information pertaining to loans underwritten by WaMu  
19 and sold to large institutional investors. Due diligence by these institutional investors often  
20 revealed that individual loans that had been designated as fully documented, actually had limited  
21 or no documentation. These situations were monitored because it affected the eventual pricing of  
22 the loans in the secondary market. WaMu was supposed to be incorporating “up to 3/8 of a  
23 point,” or 0.375%, for the “documentation relief.” The frequency with which this occurred made  
24 CW 57’s job more difficult to effectively price and manage the sale of many bulk whole loan  
25 portfolios to institutional buyers.  
26  
27

1           354. As discussed below, these “liar’s loans” were also prevalent in the Company’s  
2 subprime operations, where the Company made loans to borrowers with admittedly poor credit,  
3 based on assets and income for which the Company did not seek documentation.

4           355. Even the “conforming,” supposedly standard prime loans that WaMu sold to  
5 GSEs had substantial defects as a result of WaMu’s overly permissive underwriting. For  
6 example, through its investigation, Lead Plaintiff obtained a non-public reported entitled “Loan  
7 Disposition Summary” for a December 2005 pool of “conforming” WaMu loans sold to Freddie  
8 Mac. These summaries indicated that for the \$145 million pool of ostensibly conforming WaMu  
9 loans, over one third of the loans were rated 2W, or had “material exceptions waived.” These  
10 exceptions related directly to the credit-worthiness of the borrower, with large categories of  
11 exceptions relating, *inter alia*, to appraisals, borrower’s income, borrower’s assets, and credit  
12 history.  
13

14           356. Similarly Confidential Witness 58 was Assistant Vice President of Credit Due  
15 Diligence in WaMu’s Capital Markets Group from 2005 through January 2007. CW 58 was  
16 responsible for performing due diligence on pools of loans being sold into the secondary market  
17 by WaMu. The pools included prime and Alt-A loans.  
18

19           357. CW 58 said that “a lot” of the loans in these pools were Option ARMs which had  
20 “neg am-ed to 125% LTV.” In fact, CW 58 said, “We’d sell entire pools like that.” CW 58 also  
21 related that the Company would pool “stated” Option ARM loans at 125% LTV as long as the  
22 borrower had a certain FICO score. CW 58 verified that the vast majority of these toxic loans  
23 were originated by WaMu.  
24

25           358. CW 58 explained that, during the due diligence process for pools of loans to be  
26 sold or securitized into the secondary market, the due diligence group analyzed only a certain  
27

percentage, typically 10-15%, of the loans. Loans that did not conform to the buyer's requirements would be "kicked out." Some loans were then to be "re-pooled" at a later date in hopes that it would not be picked out for due diligence and could "skate[] through." CW 58 stated that if a loan was truly not sellable to third parties because of nonconformity with appropriate underwriting standards, it then became part of WaMu's own held-for-investment portfolio.

359. CW 58 participated in monthly national conference calls and would voice concerns to WaMu management, including Mark Brown, National Underwriting Manager, about the types of loans that WaMu was originating. CW 58 said that during the last six months of CW 58's tenure with the company, CW 58 was very vocal about her concerns over the types of loans that WaMu was originating.

360. CW 58 said that "WaMu would get pissed about the loans in their portfolio." Further, CW 58's group was "getting heat" from WaMu management over why these unsellable loans were increasingly being left in WaMu's "held for investment" portfolio. Juanita Gephardt, Vice President of Warehouse Management/Due Diligence at Washington Mutual Bank, would often complain to CW 58 and ask "How come you can't sell the loans?" CW 58 would respond that it was because "they are broken." CW 58 said that CW 58 began to notice an increase in loan "kick-outs," or rejections based on nonconformity (i.e., poor underwriting) starting in July of 2006, around the time when CW 58's unit was moved from Seattle, WA to Florence, SC. At that time, CW 58's group was increased from a staff of five to a staff of fifteen, so as to "try to help clear issues" on rejected loans.

361. CW 58 recalled that WaMu's senior management received a report entitled the "PURT report," which broke down all loans rejected by branch and detailed the reason why the

1 loans had been rejected. CW 58 said that the PURT report was updated weekly and “went to the  
2 upper management.”

3 362. CW 59 served at WaMu beginning in 2001, and acted as a Senior Risk Analyst in  
4 the Risk Analytics Group at WaMu from April 2007 until June 2008. According to CW 59, in  
5 general, the Risk Analytics Group conducted credit risk analyses on the various portfolios  
6 managed by the separate business units at WaMu, including home loans, commercial loans and  
7 credit card portfolios, including analyses of financial results, delinquency and loss trends,  
8 performance drivers and correlation analysis pertaining to economic trends.  
9

10 363. CW 59 explained that the Risk Analytics Group focused on the analysis of such  
11 issues as delinquencies, cure rates and vintage analysis of the loan portfolios. CW 59 explained  
12 that the most notable issue that was consistently discussed in WaMu internal management  
13 meetings pertained to the Option ARMs portfolios, including the fact that there were trends being  
14 observed by WaMu insiders of increasing default rates of Option ARM loans that WaMu  
15 originated in 2006.  
16

17 **c. WaMu’s Option ARM Underwriting**  
18 **Was Dangerously Deficient**

19 364. Several of WaMu’s former employees observed how WaMu’s lenient underwriting  
20 standards negatively impacted the quality of the Company’s Option ARM loans. As discussed  
21 above, Option ARM loans are adjustable-rate mortgage loans that give the borrower the option  
22 each month to make a fully-amortizing, interest-only, or minimum payment, and to amortize any  
23 unpaid interest onto the principal of the loan (referred to as “negative amortization”). WaMu  
24 offered a low “teaser” rate for an introductory period of the loan, which automatically adjusted to  
25 a much higher rate, the “fully-indexed” rate, after a set period of time, or after a certain amount  
26 of unpaid interest had been amortized onto the principal. By way of an example, the teaser rate  
27

1 for such a loan could be 2% for one year, after which the rate would increase to a fully indexed  
2 rate of 9% or thereabouts.

3 365. These loans, with the inherently risky feature of negative amortization and  
4 potential payment shock when the interest rates automatically adjusted, were made all the more  
5 dangerous by sales and underwriting at WaMu that did not ensure that a borrower was  
6 knowledgeable of the complex nature of the loan and that did not ensure that borrowers had  
7 sufficient income and assets to pay the loan at the fully-indexed rate. Indeed, as set forth above,  
8 CW 47 recalled a 2003 conversation with Mark Hillis, WaMu's former Retail and Home Loans  
9 Chief Credit Officer, in which Hillis prophesied that *within five years, 85% of WaMu's ARM*  
10 *borrowers would not be able to afford their mortgage*. However, these loans were WaMu's  
11 "flagship product" and provided huge, short-term profit margins to the Company, and according  
12 to CW 47, the Company was actually willing to make *greater FICO exceptions* for Option ARM  
13 products than for other loans.  
14  
15

16 366. Because WaMu's Option ARM loans were of particular concern to investors who  
17 wanted to make certain that the Company was not underwriting high-risk loans with potentially  
18 high profit margins, at the expense of massive future credit losses, Defendants regularly and  
19 falsely reassured investors of the strength of the Company's underwriting for Option ARM loans.  
20 In specifically addressing concerns about the Company's Option ARM portfolio, Defendant  
21 Cathcart stated during WaMu's 2006 Investor Day, "At origination, WaMu focuses on an  
22 effective underwriting process and borrower disclosures through our experienced sales force and  
23 broker channels." As detailed in Sections VI.B and VI.C, this was untrue.  
24

25 367. Furthermore, Defendants stated, repeatedly and falsely, that the Company  
26 underwrote its Option ARM loans to the fully-indexed rate, thus helping to prevent payment  
27

1 shock when the “teaser” rate ended. For example, on a January 18, 2006, earnings call for fourth  
2 quarter and full year 2005, Defendant Rotella emphasized that “*an important fact is we*  
3 *underwrite every loan at the fully indexed rate*. And so that’s an important thing to note from a  
4 credit perspective.” Defendant Killinger continued this deception at a November 16, 2006,  
5 investors conference: “Our option ARM portfolio quality is also very good . . . . This quality  
6 reflects the option ARM underwriting which evaluates the borrower’s ability to make the loans’  
7 fully amortizing payments, even though they are allowed to make a much lower initial payment.”  
8 Defendant Killinger continued in this vein, announcing definitively: “Let me make one clear  
9 point. *In our underwriting on option ARMs we underwrite to the fully indexed rate, we never*  
10 *underwrite to the teaser rate*. And so, again, we don’t see this as having a significant impact on  
11 the underwriting for us.”  
12

13  
14 368. This claim was particularly crucial to investors, as Defendants knew, because the  
15 monthly payment for borrowers at the fully-indexed rate could be a dramatically higher burden  
16 than the monthly payment at the initial, teaser rate. Although a borrower may be able to repay a  
17 loan at a 2% interest rate for an initial teaser period, once the interest rate automatically adjusted  
18 to the fully-indexed rate that could be 9.95%, if not higher, repayment could be impossible for  
19 the borrower. The difference in monthly payments between these two rates is astronomical. For  
20 a \$200,000, 30-year loan, a borrower may be able to pay \$740 a month at a 2% interest rate.  
21 However, once the loan reset to a 9.95% interest rate, the borrower would suddenly be faced with  
22 a monthly payment of \$1750 – an increase in monthly expenses of over \$1000, or over 235% of  
23 the original payment. If the loan is underwritten only to ensure that the borrower able to afford a  
24 \$740 monthly payment, rather than the fully-indexed rate, then the financial shock of the reset  
25 could easily force the borrower into default, causing credit losses to WaMu. However, if WaMu  
26  
27

1 had originally underwritten the loan to ensure that the borrower could pay \$1750 a month and  
2 merely offered the teaser rate of 2% as an enticement to borrow from WaMu, then the credit risk  
3 would be much lower.

4       369. This credit risk is exacerbated by the fact that WaMu's Option ARM loans  
5 provided borrowers with the option to make only a "minimum payment" of an amount less than  
6 the currently-due interest, not including the principal due. In other words, WaMu's Option ARM  
7 loans allowed the borrower to negatively amortize some part of the accruing interest and add it to  
8 the principal of the loan. However, once the negatively amortized interest, together with the  
9 principal, reached 125% of the amount of the original loan (or 110% for part of the Class  
10 Period), the loan would be "recast" at a much higher interest rate and then amortize over the  
11 remaining term of the loan. This means that after the recasting event, the borrower would be  
12 required to repay the original loan balance, in addition to all interest deferred, at a higher interest  
13 rate. In other words, borrowers were left in a worse financial position than before they were  
14 issued the loan.

15       370. For example, if after three years a borrower hit the 125% negative amortization  
16 cap of a \$200,000, 30-year loan (a total of \$250,000), the borrower's monthly payments would  
17 recast to reflect a fully-indexed rate of (for example) 9.95%, amortized for the remainder of the  
18 loan. In this instance, the borrower's initial teaser rate may have been \$740, but their monthly  
19 payment for the remaining twenty-seven years would be \$2225.

20       371. Thus, underwriting Option ARM loans to the teaser rate is incredibly dangerous  
21 from a credit standpoint and has extremely negative implications for the borrower. It is also  
22 contrary to what WaMu told the investing public it was doing. Yet, that is exactly what WaMu  
23 did.

372. Confidential Witness 60, a Retail Loan Consultant with WaMu from 2002 through 2007, reported that *until late 2007*, WaMu had underwritten its Option ARM loans to ensure only that the borrower could make monthly payments at the “teaser” rate. When, in late 2007, the Company changed its guidelines to finally require its underwriters to underwrite the loans to the fully-indexed rate, it was a major change for the underwriters. CW 60 observed that, “At the time the loans started falling out of favor, they started underwriting based on the index rate and it just snowballed from there.”

373. Confidential Witness 61, a WaMu Retail Loan Consultant in Kensington, Maryland from 2001 through December 2007, confirmed that WaMu underwrote Option ARM loans to the teaser rate, rather than the fully-indexed rate. In 2007, according to CW 61, WaMu’s new guidelines resulted in fewer borrowers being able to qualify for Option ARM loans based on the fully-indexed rate.

374. Confidential Witness 62, a Senior Underwriter at the WaMu’s Lake Success, New York branch from June 2005 until February 2008, confirmed that during the Class Period, WaMu underwrote Option ARM loans to the teaser rate, rather than the fully-indexed rate. Confidential Witness 12, a former Loan Consultant for WaMu in Riverside, California, also confirmed that WaMu underwrote its Option ARM loans to the “teaser” rate, rather than the fully-indexed rate.

375. Witnesses in other divisions of WaMu also have confirmed that WaMu underwrote its Option ARM loans to their “teaser” rates, at least until August 2007. According to Confidential Witness 1, a Due Diligence Director in the WaMu Transaction Management group in Anaheim and subsequently Fullerton, California, who spent over 17 years with WaMu from 1991 until 2008, WaMu required loans that it purchased from third parties to conform with underwriting guidelines that WaMu applied to the loans that it originated. CW 1 explained that



1 this meant that the due diligence on loans that WaMu was purchasing from other lenders was  
2 performed based on an “overlay” of WaMu’s underwriting guidelines over the third party loans  
3 and that any loans that did not conform to WaMu’s own underwriting guidelines were supposed  
4 to be excluded from WaMu’s purchases of loans originated by third parties. Thus, WaMu  
5 periodically updated its “Bulk Seller Guide” to conform with WaMu’s own underwriting  
6 requirements, including in August 2007. Until August 1, 2007, WaMu did not require its own  
7 Option ARM loans to be underwritten to the loans’ fully-indexed (rather than “teaser”) rate,  
8 contrary to the Officer Defendants’ numerous public statements, and likewise did not impose  
9 such a requirement on loans purchased from third parties. This is confirmed by a document  
10 obtained in the course of Lead Plaintiff’s investigation authored by WaMu and entitled  
11 “Mortgage Securities Corp. Seller Guide Update – Announcement Concerning Qualifying Rate  
12 and Qualifying Payment for Hybrid ARM, IO, and Option ARM Products.” That document  
13 indicates that, effective August 1, 2007, WaMu Option ARM loan underwriting shifted to require  
14 qualification for such loans only at the fully-indexed rate.  
15

16  
17 **2. WaMu Also Secretly Implemented**  
18 **Dangerously Permissive Underwriting**  
19 **Practices for Its Subprime Lending**

20 376. Throughout the Class Period, WaMu made loans to “subprime” borrowers through  
21 its subprime channel, LBM. In 2006, LBM was consolidated into the Home Loans Group, and  
22 Company’s subprime lending (formerly LBM) was referred to in the Company’s SEC filings as  
23 WaMu’s “specialty mortgage finance operations.” This reorganization did nothing to modify  
24 WaMu’s subprime lending practices.

25 377. Although WaMu itself does not specifically define “subprime” borrowers,  
26 subprime loans are generally made to borrowers with lower FICO scores who could not normally  
27

1 obtain prime loans. Because subprime borrowers' credit scores indicated that they were less  
 2 creditworthy than WaMu's "prime" borrowers, WaMu was able to charge much higher interest  
 3 rates and fees on these subprime loans. However, WaMu also assured investors that although  
 4 loans were being made to borrowers with low FICO scores, the Company's purportedly rigorous  
 5 underwriting standards guarded against excessive credit risk to the Company. For example, the  
 6 Company's Amended 2005 Form 10-K announced that, "[t]he Company seeks to mitigate the  
 7 credit risk in [WaMu's subprime] portfolio by ensuring compliance with underwriting standards  
 8 on loans originated to subprime borrowers and by re-underwriting all purchased subprime  
 9 loans." As set forth below, WaMu made a similar reassurance in its 2006 Form 10-K.

11 378. Furthermore, in July 2006, Defendant Rotella claimed that with regard to the  
 12 Company's subprime lending, "we're being quite careful and making any changes we need to  
 13 make in our credit policies as we move forward, but our sense of things are – things are in pretty  
 14 good shape." As the Class Period progressed, at WaMu's 2006 Investor Day, in September 2006,  
 15 Defendant Schneider claimed that:

17 On subprime, we have seen, as others have seen, some early payment default and  
 18 repurchase activity. We saw most of that occur for us in late '05, Q4 '05, and first  
 19 quarter of '06. We *reserved for it appropriately* and we have also, in second  
 20 quarter of '06, *tightened up a number of our underwriting guidelines*, and you  
 can see that in our numbers."

21 In fact, we think *we've lost probably a percentage or so of market share over the*  
 22 *past year as a result of tightening some of the credit guidelines in our subprime*  
*business*. And we think that was the *prudent* thing to do and actually we think  
 we're ahead of many of our competitors here.

23 379. The FDIC issued specific warnings regarding subprime lending to mortgage  
 24 lenders as early as 1993 and extending throughout the Class Period. For example, in 1999, the  
 25 Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit  
 26 Insurance Corporation, and the OTS (the "Agencies") jointly issued the Interagency Guidance on

1 Subprime Lending, which gave extensive guidance to subprime lenders regarding risk  
2 management and appropriate credit loss reserving. The guidance noted, *“If the risks associated*  
3 *with this activity are not properly controlled, the agencies consider subprime lending a high-*  
4 *risk activity that is unsafe and unsound.”*

5  
6 380. However, just as in the Company’s prime and Option ARM lending, the Company  
7 covertly instituted extremely loose subprime lending guidelines so that WaMu employees could  
8 push subprime loans through. This occurred at the direction of the Officer Defendants.  
9 Confidential Witness 63 served as a former National Underwriting Manager of WaMu’s LBM  
10 beginning in September 2006 and a Regional Operations Manager for LBM prior to that  
11 position. According to CW 63, Defendant Schneider, President of the Home Loans Group, and  
12 his management team were particularly focused on preserving LBM’s growth. This was because,  
13 CW 63 observed, LBM was considered by the Officer Defendants to be the “golden child” of  
14 WaMu; although it did not account for the preponderance of WaMu’s overall earnings, it had a  
15 much higher growth rate and higher growth potential than WaMu’s other divisions. CW 63  
16 reported that WaMu was therefore eager to produce a high volume of loans through LBM.  
17 Moreover, WaMu’s Capital Markets group, which CW 63 described as the “magic center in  
18 Manhattan that told you what your profits were,” demanded a continuous stream of LBM loans.  
19

20  
21 381. Confidential Witness 64, a longtime employee of LBM, noted a shift in  
22 underwriting philosophy in 2005 toward increasing loan volume at all costs. CW 64 was an  
23 Account Executive for LBM in New Jersey from 1998 until October 2007. When CW 64 first  
24 joined the subprime business, LBM relied on “common sense underwriting” and was not  
25 exclusively focused on credit scores. Subprime loan originators wanted to know about the  
26 borrower rather than relying strictly on a number. As time went on, LBM came to rely more on  
27

1 score and less on common sense. Over the years, the borrower needed to produce less and less  
2 documentation and FICO scores became more important than verifying income for WaMu. CW  
3 64 noted the change from a “know your borrower” focus to a credit score focus beginning in the  
4 2005 timeframe. In response, “volume really went through the roof.”

5  
6 382. LBM met WaMu’s needs by pushing through every loan it could close, through  
7 whatever means necessary. Confidential Witness 65 a Senior Underwriter for LBM in Dallas,  
8 Texas, from 2004 through April 2007, reported that on occasion CW 65 would express concerns  
9 over funding some of the loans underwritten to her manager, Lisa Wagner, Vice President and  
10 Loan Fulfillment Site Manager, but Wagner’s “direction from corporate” was simply to fund  
11 loans. CW 65 said that LBM’s underwriting guidelines became “ridiculously” loose toward the  
12 end of 2005. The division’s goal was to break “funding records.”

13  
14 383. CW 65 also reported that at month-end team meetings, it would often be  
15 discussed about how the Company was trying to increase volume by loosening up guidelines and  
16 getting more “borrowers to fit.” Once per quarter, either Defendant Killinger or Defendant  
17 Rotella would issue internal e-mails and pre-recorded statements detailing the structure of the  
18 guidelines and explaining that the company was changing the guidelines in an attempt to increase  
19 volume.

20  
21 384. CW 65 recalled that some of the “crazier” programs at WaMu’s LBM included  
22 stated-income W-2 wage earners, a program that started in 2005. Stated-income programs, to the  
23 extent that lenders accepted them, were traditionally reserved for self-employed borrowers with  
24 significant assets. At LBM, these “liar’s loans” were common, including for those who were not  
25 self-employed. LBM would also accept 100% financing, stated borrowers with FICO scores as  
26 low as 500. Another program CW 65 questioned was the self-employed borrower “three letters  
27

1 of reference” program. Within this program, a borrower would only have to submit three letters  
2 of reference from anyone for whom they supposedly worked. CW 65 said there was no attempt  
3 made to verify the information in the letters. CW 65 related that some of the accepted letters  
4 were laughable, including statements such as: “So-and-so cuts my lawn and does a good job.”  
5 FICO scores ranged from 500-620 but CW 65 said that if LBM salespeople had a borrower with  
6 a 620, they were “hooping and hollering” about having a borrower with good credit.  
7

8 385. CW 65 also relayed that borrowers could get a loan with no established FICO  
9 score merely by providing “three alternative trade lines.” An “alternative trade line” was  
10 anything that did not appear on the borrower’s credit report, including documentation of car  
11 insurance payments, verification of rent paid, or a note from a person claiming the borrower had  
12 repaid a personal debt. For first-time home borrowers, as long as the borrower had a “verification  
13 of rent” from anybody – a family member or a friend – and LBM could verify a phone number,  
14 the letter was accepted. CW 65 commented, “It was just a disaster.” CW 65 said that LBM  
15 originated a “good chunk” and a “a significant amount,” of these types of problematic loans.  
16 Furthermore, CW 65 said, that these loans made up the majority of first payment defaults  
17 (“FPDs”) in the end of 2006. CW 65 was extremely knowledgeable about the causes of FPDs in  
18 LBM because CW 65 was a member of an “FPD task force” commissioned to audit FPDs and  
19 determine “what went wrong.”  
20  
21

22 386. Confidential Witness 66 served as an LBM Senior Underwriter in the Chicago  
23 area from 2004 through September 2007. CW 66 felt that there were significant flaws in the  
24 Company’s underwriting procedures. CW 66 described the culture of LBM as: “it was just do  
25 it.” CW 66 further explained that “There were really no restrictions to approve a loan,” and  
26 some “really bad loans” went through the office. Just as former WaMu employees reported from  
27

1 the prime side, CW 66 also stated that WaMu's attitude in its subprime lending was "push, push,  
2 push," and WaMu management did not care about underwriting guidelines. Confidential Witness  
3 30, an Account Executive with LBM in New Jersey and Philadelphia from 2004 until September  
4 2007, agreed: "[LBM's] underwriting guidelines were pretty much an exception as it is." In  
5 other words, the LBM underwriting guidelines were incredibly permissive so that more loans  
6 could close.  
7

8 387. A particular example stood out in CW 66's mind as paradigmatic of LBM's  
9 concern for loan volume over credit quality. As LBM was a wholesale company, it received  
10 loans from brokers through various loan officers. CW 66 was responsible for reviewing the file  
11 and ensuring that there was no fraud. While reviewing the assets and credit in one file, CW 66  
12 realized that the "customer" (broker) was flipping properties. CW 66 thoroughly investigated the  
13 broker and realized that he was perpetrating an extensive fraud on his borrowers that was not  
14 only illegal, but dramatically raised the credit risk of the loans that the broker "flipped." CW 66  
15 collected all of the supporting documentation and brought the findings to Wendy Allbee, an LBM  
16 team manager. Allbee informed the Assistant Vice President over all sales associates, Terry  
17 Headberg, of CW 66's findings. CW 66 told them that CW 66 was going to decline the loan, not  
18 only because the broker was targeting seniors and minorities, but also because these loans would  
19 obviously lead to a great deal of defaults and foreclosures. Allbee, with the support of other  
20 LBM management, overturned the decision and approved the loan, pointing out that the broker  
21 gave WaMu a lot of loans.  
22  
23

24 388. According to CW 66, even the few loans that LBM underwriters refused to  
25 approve were regularly pushed through by WaMu's LBM management regardless. For example,  
26 according to CW 66, Alvida Marchuk, an Assistant Vice-President, had to approve the file if the  
27

1 team manager and an underwriter were in disagreement, and Marchuk always pushed loans  
2 through. CW 66 explained that loans were pushed through because that is what senior  
3 management was forcing LBM to do. According to CW 66, "There were so many exceptions."  
4 LBM allowed LTV ratio exceptions, and the "rate exceptions were ridiculous." WaMu allowed  
5 even the salespeople to give interest-rate exceptions to borrowers to push loans through.  
6

7 389. CW 66 also reported that LBM pushed borrowers into loans with negative  
8 amortization features and interest-only loans. CW 66 explained that on LBM's interest-only  
9 loans, the borrower pays only interest for two years, but after two years, the payments go up.  
10 The borrower's monthly payment could increase from \$1000 a month to \$2000, but (as with  
11 WaMu's prime ARM products, as described above) LBM would qualify the borrowers based  
12 only on the interest-only payment of \$1000.  
13

14 390. According to CW 66, LBM did not have its own Human Resources Department; it  
15 shared WaMu's. CW 66 said that many people at LBM tried to relay the numerous issues with  
16 LBM's borrowers to WaMu management by contacting WaMu Human Resources, but their  
17 concerns were always ignored. In addition, to CW 66's knowledge, several LBM employees  
18 contacted WaMu corporate headquarters about these dubious practices.  
19

20 391. CW 66 said, "[w]e did a lot of underhanded stuff" because senior management  
21 was forcing us to do so. Every underwriter that CW 66 knew who had a problem with LBM over  
22 a decision made on a file was written up, not because they made a bad decision but rather  
23 because Sales did not like their decision. CW 66 said: "Basically Sales is what ran Long Beach  
24 Mortgage, it wasn't the Operations part."  
25

26 392. Confidential Witness 67 served as a Quality Assurance Manager in the LBM Loan  
27 Fulfillment Center ("LFC") in Dallas, Texas from November 2005 until his termination in  
28



1 August 2007. In this capacity, CW 67 was involved in the post-funding review of subprime  
2 loans for the purpose of establishing that funded loans were meeting regulatory and company  
3 compliance policies.

4 393. CW 67 explained that the Quality Assurance group in Dallas performed a monthly  
5 audit on a random selection of subprime loans from the various loan origination centers around  
6 the country. CW 67's group reviewed the loans to identify "events" that included notable issues  
7 pertaining to underwriting. This analysis was not focused on loan-specific issues, but instead  
8 concerned Company-wide trends within these "events" that might suggest necessary changes in  
9 WaMu's underwriting guidelines, compliance standards, or other systems. The group attempted  
10 to determine the cause of these events so that it could be addressed from an operational  
11 standpoint.  
12

13 394. CW 67 observed that, despite the extensive analysis that the group performed to  
14 determine the root causes for Company-wide loan problems, WaMu ignored the results of that  
15 analysis. According to CW 67, there was "a lot of analysis but not a lot of action." CW 67's  
16 group continued to identify the same problematic trends again and again without the Company  
17 taking any steps to address the causes. CW 67 did not fault CW 67's managers for their lack of  
18 action, stating that they could not have pushed any harder to get the Company to address the  
19 potential risks that were being identified. Unfortunately, CW 67 said, WaMu "just ignored"  
20 them.  
21

22 395. The issues identified by CW 67's group, which WaMu ignored, included issues  
23 relating to the underwriting guidelines. As a result, CW 67 felt that despite his group's efforts to  
24 mitigate the risks pertaining to LBM's underwriting guidelines, the underwriting guidelines were  
25 "just a joke." For example, CW 67 reported that a customer with a 550 FICO score might  
26  
27



1 borrow one loan up to 80% on the value of a home, then simply get another loan for the  
2 remaining 20%. CW 67 observed that no other lending institution would issue a 100% loan to  
3 borrowers with such low credit standings and then be “surprised” when that borrower defaulted.  
4 Indeed, according to CW 67, “everyone” at WaMu was well aware that those types of loans were  
5 permitted on a regular basis. Despite CW 67’s best efforts to mitigate those risks, WaMu’s  
6 ultimate objective was simply to approve loans. According to CW 67, although WaMu was  
7 “going through the motions” to present a façade of legitimate quality control, in reality there was  
8 nothing but a “free for all to approve loans by the thousands.”

10 396. Confidential Witness 68 was a Wholesale Mortgage Underwriter at the LBM loan  
11 processing center located in Lake Oswego, Oregon from August 2005 until December 2006. CW  
12 68 first joined Washington Mutual in Lake Oswego in 2003 as a Senior Credit Analyst and  
13 subsequently joined the operations of LBM in 2004 as a Senior Loan Coordinator, ultimately  
14 becoming a Wholesale Mortgage Underwriter. In this capacity, CW 68 was responsible for  
15 examining all loan applications submitted by various mortgage brokers to review accuracy of  
16 information, adherence to underwriting guidelines, and to determine fraud risk, credit history,  
17 employment and income calculations pertaining to subprime loan applications.

19 397. CW 68 said that at LBM there was always a sense of “working the underwriting  
20 guidelines” to close loans, rather than to mitigate the Company’s credit risk. CW 68 maintained  
21 that underwriters were continuously taking great liberties in interpretation of the guidelines and  
22 providing exceptions to any application that did not fit the guidelines precisely. CW 68 said that  
23 there was simply an environment in the loan processing center to “approve, approve, approve”  
24 and that any exception that was needed to approve a loan was not only done, but it was “sought  
25 after.” CW 68 felt that the Company consistently pressured its underwriters to “find a way to  
26  
27

1 make it work.” CW 68 estimated that perhaps only 1% of all loans submitted were actually  
2 rejected.

3 398. CW 68 felt that Company management consistently encouraged underwriters to  
4 get loans closed to stay competitive and to maintain their market share. CW 68 said that the  
5 underwriters believed that they were supposed to be there to protect the bank from making bad  
6 decisions but, unfortunately, there was no real focus on the quality of the loans that were being  
7 approved. According to CW 68, CW 68’s colleagues at LBM were very disappointed about the  
8 decisions that were being made by WaMu about loan quality, but they were resigned to simply  
9 “keep their heads down.”  
10

11 399. Similarly, Confidential Witness 69, a Senior Underwriter for WaMu in Livermore,  
12 CA from 2003 to September 2007, agreed that not only were LBM’s guidelines loose, but LBM  
13 was also willing to make numerous exceptions to its already-loose guidelines. CW 69 said that if  
14 LBM’s competitors could not approve a loan, it was known to send the loan to LBM and they  
15 would make an exception to get the loan through. CW 69 said that guidelines were “loose to the  
16 point of disbelief.” LBM accepted 500 FICO scores with bankruptcies. CW 69 described LBM’s  
17 lending approach as follows: “If [potential borrowers] were breathing and had a heart beat, you  
18 could probably get the loan done.”  
19

20 400. Confidential Witness 70 served as a Senior Underwriter for WaMu’s LBM in  
21 Denver, CO from 2002 until November 2007. During that time, CW 70 underwrote loans from  
22 around the country. CW 70 recalled that, over time, WaMu’s underwriting guidelines  
23 progressively loosened more and more. During CW 70’s final eighteen months with WaMu, the  
24 Company reached the point where it was regularly pushing through loans that had been evaluated  
25 by underwriters and rejected. Typically, if an underwriter declined a file, the file would be  
26  
27

1 escalated and then sales manager would discuss the loan with the underwriting manager. To CW  
2 70 and the other underwriters at WaMu, it seemed that “sales was putting more and more  
3 pressure on underwriting.” CW 70 said that “[s]ales ran things at WaMu because they were the  
4 ones ‘bringing in the business.’” According to CW 70, sales drove what happened inside WaMu,  
5 even to the detriment of the quality of the loans.  
6

7 401. CW 70 recalled that LBM encouraged underwriters to make numerous exceptions  
8 to its underwriting guidelines. CW 70 recalled that numerous loans with more than two  
9 exceptions on the same loan were pushed through. Even when underwriters refused to sign off  
10 on loans, WaMu gave mid-level managers who had never underwritten a loan before the  
11 authority to override the underwriters’ decisions. CW 70 observed that these decisions had  
12 predictable effects – many of the files began to appear as first payment defaults.  
13

14 402. Confidential Witness 71 observed the same practices at LBM during the Class  
15 Period. CW 71 was an Underwriter for LBM in Englewood, Colorado, from September 2005  
16 through December 2006; prior to that position, CW 71 was a Senior Loan Coordinator with  
17 WaMu from 2003-2004. CW 71 would often use tools like Lexis/Nexis in an attempt to uncover  
18 fraud in loan applications but many times was admonished by CW 71’s manager, who cautioned  
19 that CW 71 was “digging too deep” and to “just go ahead” and do the deal. Laura Ranum, CW  
20 71’s team manager, actually left LBM because she did not agree with the way loans were  
21 underwritten. CW 71’s new manager was more “sales oriented” and would often grant  
22 exceptions to the guidelines, with his “Let’s do the loan” mantra.  
23

24 403. Confidential Witness 72 observed that “in the heyday [at LBM], everything was  
25 getting approved.” CW 72 was an account executive for LBM in New York from 2004 to  
26 December 2007. According to CW 72, everything at LBM was “very lenient.” For example,  
27

1 LBM originated loans with 106% LTV ratios (intended to cover the closing costs) with FICO  
2 scores as low as 575. CW 72 said that a borrower could also get a loan with little documented  
3 credit, such as a single credit line with Sears for \$500.

4 404. Confidential Witness 73 worked for WaMu's LBM as an underwriter in 2006 –  
5 CW 73 decided to quit her job at WaMu's LBM after only three months because of "how loose  
6 WaMu's underwriting guidelines were." Compared with CW 73's previous experience in  
7 mortgage underwriting, going to work for LBM was a "hard transition." Certain issues were  
8 particularly egregious to CW 73, including the fact that LBM did not require purportedly self-  
9 employed borrowers to have a tax preparer or CPA certification. LBM accepted three letters of  
10 reference from the borrower's clientele as sufficient to prove the borrower's credentials.  
11 According to CW 73, underwriting that included verifying the borrower's employment was not  
12 the priority at LBM; instead, the sales side "really had control" and was "in cahoots with  
13 management."  
14

15  
16 405. CW 73 recalled that, although CW 73 did not underwrite Option ARM loans, it  
17 was generally known among underwriters at WaMu that WaMu's prospective Option ARM  
18 borrowers were qualified at the teaser rate.

19 406. Confidential Witness 74 served as an underwriter for WaMu's LBM in Atlanta,  
20 Georgia from 1994 until May 2006. CW 74 reported that, in 2006, the "[underwriting]  
21 guidelines began to change drastically." CW 74 felt that the Company was "changing programs  
22 to make loans fit better." CW 74 recalled numerous loans that LBM should not have granted, but  
23 the edict from management was to do what it took to "get it to fit."  
24

25 407. CW 74 confirmed that many of the loans that LBM issued were stated-income  
26 loans. At LBM, if an underwriter did not feel comfortable signing off on a loan, an LBM  
27

1 manager often would. These practices, CW 74 recalled, resulted in greater and greater numbers  
2 of foreclosures and early payment defaults beginning in 2006.

3 408. Confidential Witness 75 worked as underwriter in WaMu's subprime division in  
4 Plantation, Florida, during 2006. During that time, CW 75 recalls, "things started going  
5 downhill and rules got more lenient." Among WaMu employees, "Rumors started to fly that [the  
6 Company was] starting to lose it." Indeed, the overriding theme during CW 75's tenure with  
7 WaMu was "when push came to shove" WaMu's way of thinking was "let's push things  
8 through."

9  
10 409. CW 75 became increasingly aware during her time at WaMu that most of WaMu's  
11 loans that she would underwrite were stated-income income loans, with only a "VOE," or  
12 verification of employer, required. CW 75 recalled, "It could be from their mother; we wouldn't  
13 know on our end. It's a stated deal and we couldn't ask for more documents even though [we  
14 felt it necessary]. It became a joke." In sum, in CW 75's experience at WaMu, "A lot of things  
15 were signed off on that I didn't think should have been."

16  
17 410. Confidential Witness 76 worked for LBM from 2004 through 2007 as a loan  
18 processor in Anaheim, California. In CW 76's experience in the mortgage-lending industry, CW  
19 76 felt that LBM's underwriting guidelines were particularly lenient. For example, CW 76  
20 recalled that, at a mortgage-lending company where CW 76 had previously worked, even stated-  
21 income loans required certain minimum FICO scores and proof of assets. However, LBM did  
22 not require even these basic credentials from borrowers to grant a stated-income loan. LBM did  
23 not require proof of assets, even when lending to individuals with low credit scores.

24  
25 411. For those loans for which CW 76 or the loan underwriter was not comfortable  
26 with the documentation, their LBM superiors would review the file. In CW 76's experience,  
27

1 “somehow [LBM management] would find a way to make it work.” This differed dramatically  
2 from CW 76’s experience at prior mortgage-lending companies. At CW 76’s prior company, “if  
3 a loan was dead, it was dead.” On the other hand, at LBM, management would do whatever it  
4 took to fit the borrower into a loan.

5  
6 **3. WaMu Inappropriately Incentivized Its**  
7 **Underwriters To Approve Loans By**  
8 **Basing Their Compensation On Loan**  
9 **Volume Without Regard To Loan Quality**

10 412. To make matters worse, in addition to WaMu’s intense pressure to push loans on  
11 unsuspecting borrowers and its relaxed underwriting standards to facilitate the closing of such  
12 loans, underwriters, who were supposedly the Company’s “gatekeepers” of loan credit quality,  
13 were also incited by WaMu to approve an enormous volume of loans without regard to loan  
14 quality. Confidential Witness 69, a Senior Underwriter with WaMu in Livermore, California,  
15 from 2003 through September 2007, confirmed that loan underwriters received commissions  
16 based upon volume of loans underwritten and closed, with no concern given to any credit losses  
17 the underwriters could prevent.

18 413. According to Confidential Witness 5, who served as Senior Credit Quality  
19 Manager from March 2005 until February 2008, after having served as a WaMu Senior  
20 Underwriter from 2003 through 2004, underwriters received massive bonuses for underwriting a  
21 high volume of loans without any regard to quality. According to CW 5, underwriters were  
22 required to underwrite a minimum of nine loans a day, and any loans underwritten in excess of  
23 that number provided for bonus payments. Indeed, certain senior underwriters earned in excess  
24 of \$100,000 annually because of these bonuses; some underwriters received monthly bonus  
25 payments of \$5,000 for underwriting a high volume of loans.  
26  
27

1           414. In fact, according to Confidential Witness 47, a long-time employee of WaMu  
2 who left after twenty-four years with the Company, WaMu was so focused on incenting  
3 underwritings and removing any barriers to closing loans that loan delinquency data was not  
4 provided to underwriters. According to CW 47, WaMu's senior management believed that if  
5 underwriters knew about underwriting problems that led to problem loans, notwithstanding their  
6 exorbitant volume-based bonuses, WaMu's underwriters would "by nature" have tightened up  
7 WaMu's lending standards – but that did not happen at WaMu.

9           415. CW 15 worked for Washington Mutual as first vice president and director of  
10 investor relations for the capital markets group at WaMu Capital Corp. in New York from  
11 October 2004 until December 2007. According to CW 15, underwriters were compensated on  
12 the volume of loans brought in and closed, with no consideration being given to the quality of the  
13 loans.

14           416. CW 77 worked for LBM from 1992 to November 2007 as a loan processor,  
15 underwriter, and loan default and fraud analyst. CW 77 noted that underwriters were paid for  
16 each loan they reviewed. As a result, CW 77 reported that LBM underwriters "would groan" if  
17 anything – including analyzing information crucial to the underwriting process – prevented them  
18 from quickly pushing loans through.

19           417. Confidential Witness 18, a Vice President in WaMu's Commercial Risk  
20 Department from April 2003 until June 2006, reported that decisions regarding measures of  
21 compensation came from "the top," and would be determined at the Executive Vice President  
22 Level, at a minimum. According to CW 18, at a minimum Defendant Rotella certainly was  
23 aware of, if not taking an active role in, decisions made to compensate WaMu employees based  
24 on loan volume without regard to credit quality.

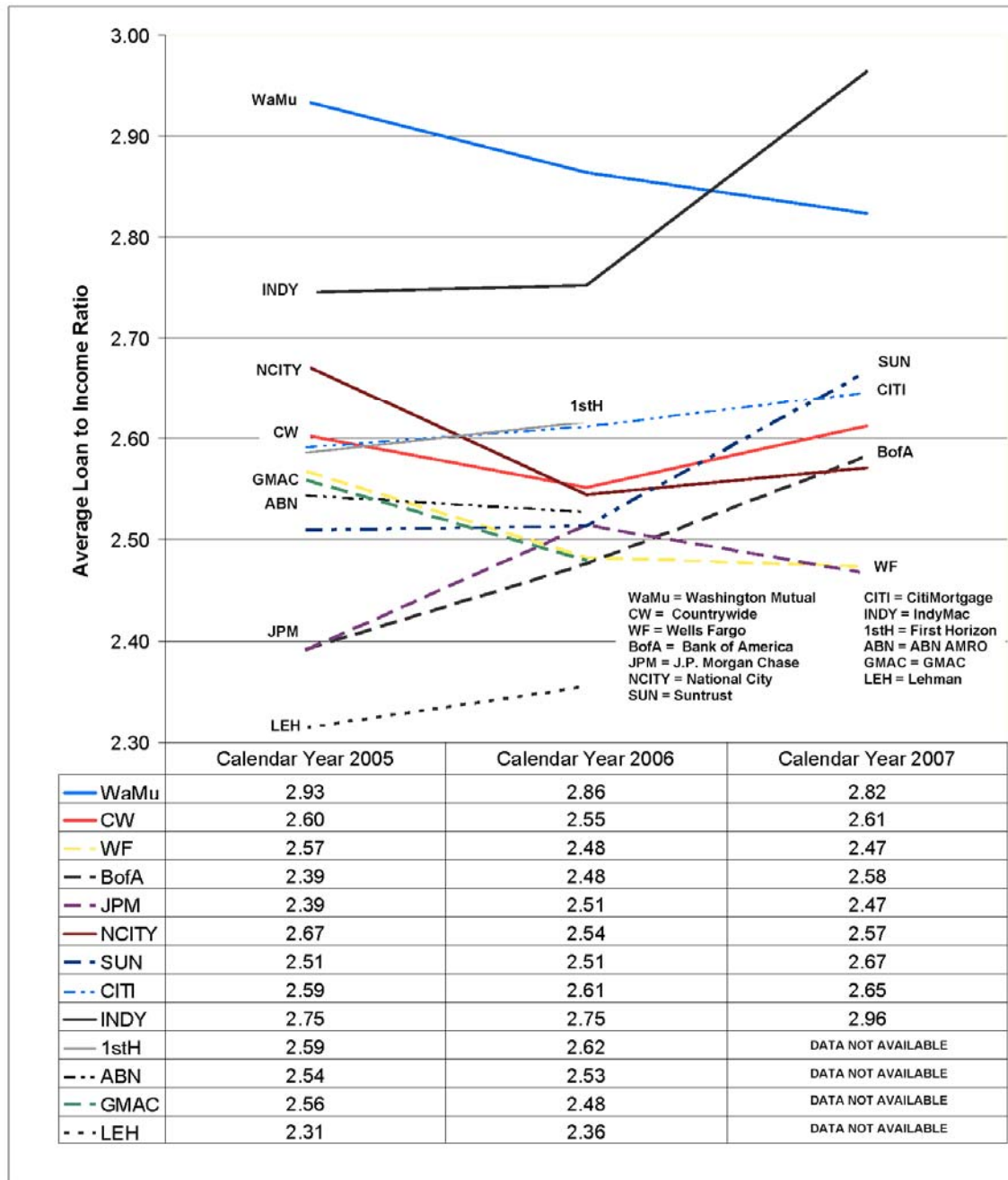
**4. Expert Analysis of Relevant Data Further Establishes that WaMu's Underwriting Standards Throughout the Class Period Were Deficient**

418. Lead Plaintiff's investigation of WaMu's underwriting practices includes the analysis of vast amounts of raw data collected by WaMu and other lenders revealing WaMu's lending practices compared to those of its peer lending companies (defined above as the "Peer Group"). For the analysis discussed below, experts in the field of banking regulation and mortgage finance employed a similar methodology as that used to produce the analysis of loan application denials, discussed above at ¶¶298-305. In both analyses, over ten gigabytes of raw HMDA data were examined, on a census tract by census tract level, to produce a robust comparison of WaMu with its Peer Group.

419. In the analysis below, Lead Plaintiff's experts examined the average loan amount to income levels of approved loan applications by WaMu, compared with its Peer Group. Chart 4, below, shows that WaMu's loans reflected much higher "loan to income" ratios than its Peer Group. Loan to income is a significant measure of credit risk, as borrowers who incur debt that is relatively high compared to their income levels have an increased risk of defaulting on their loans, as WaMu even acknowledged in its public statements: For example, in its 2006 Form 10-K, the Company announced, "In the underwriting of loans, one of many factors the Company considers when deciding whether to approve or decline a loan is the applicant's debt-to-income ratio." Clearly, a home loan of several hundred thousand dollars would represent a significant component of a typical borrower's overall debt.



**Chart 4: Average Annual Residential Loan Amount to Borrower Income for WaMu and Its Peer Group**



As shown above in Chart 4, Wamu lent relatively more money to borrowers (compared with the income of those borrowers) than any of its peers for 2005 and 2006. For example, in 2006, for a borrower that earned \$100,000 per year, WaMu would lend \$286,000 on average, whereas its next highest-lending peer in that year, IndyMac Bank, was willing to lend to that same borrower only \$275,000. In 2007, WaMu was surpassed in its aggressive lending only by IndyMac Bank. (On July 11, 2008, IndyMac Bank was placed into conservatorship by the FDIC and on August 1, 2008 filed for bankruptcy protection.)

\* \* \*

420. In sum, in contrast to WaMu's and the Officer Defendants' portrayal of WaMu's "conservative" underwriting standards, as evidenced by the detailed reports from former WaMu employees, as well as the internal WaMu documents discussed above, and expert analyses described above, it is clear that it is clear that WaMu secretly caused its underwriting standards to deteriorate during the Class Period.

**E. WaMu's Financial Statements Violated GAAP and SEC Regulations Prohibiting False and Misleading Public Filings**

421. WaMu, in reporting its financial results during the Class Period, made numerous false statements of material fact and omitted to state material facts necessary to make its reported financial position and results not misleading. As set forth below, WaMu published financial statements and information that violated generally accepted accounting principles ("GAAP") and SEC Regulations prohibiting false and misleading public disclosures.

422. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practices. The SEC has the statutory authority to promulgate GAAP for public companies, and has delegated that authority to the Financial Standards Accounting Board ("FASB").

423. The SEC requires public companies to prepare their financial statements in accordance with GAAP. In fact, as set forth in SEC Regulation S-X (17 C.F.R. § 210.4-01(a)(1)), financial statements filed with the SEC that are not presented in accordance with GAAP will be presumed to be misleading, despite footnotes or other disclosures. SEC Regulation S-X (17 C.F.R. § 210.10-01(a)(5)) also requires that interim financial statements comply with GAAP and “shall include disclosures either on the face of the financial statements or in accompanying footnotes sufficient so as to make the interim information presented not misleading.”

424. As set forth below, longstanding and fundamental GAAP precepts required WaMu and the Officer Defendants to establish a reserve for incurred credit losses resulting from borrowers defaulting on their obligations to make monthly mortgage payments or when it was probable that borrowers would do so. WaMu referred to this loss reserve as its Allowance for Loan and Lease Losses (“Allowance”).

425. WaMu’s Allowance was a critical metric for investors, for which management was directly responsible. As described in a December 2006 “Interagency Policy Statement on the Allowance for Loan and Lease Losses,” issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (“FDIC”), the National Credit Union Administration, and the OTS (collectively, the “Agencies”):

The [Allowance] represents one of the most significant estimates in an institution’s financial statements and regulatory reports. Therefore, each financial institution has a responsibility for ensuring that controls are in place to consistently determine the [Allowance] in accordance with GAAP, the institution’s stated policies and procedures, and relevant supervisory guidance.

426. Indeed, the Company’s 2006 Form 10-K explained, “[t]he [Allowance] represents management’s estimate of incurred credit losses inherent in the Company’s loan and lease

1 portfolios as of the balance sheet date.” Moreover, the Allowance was one of six “earnings  
2 drivers” that the Company discussed each quarter. During those discussions, the Officer  
3 Defendants consistently touted the soundness of WaMu’s Allowance, such as during a May 18,  
4 2006 conference call, when Defendant Killinger announced: “The next target is on the credit  
5 front. . . . Certainly we can come back in the Q&A if you want to talk more about credit; but  
6 credit for us is [in] excellent shape, and I feel very comfortable with where we are from  
7 management of that credit as well as the reserving.”  
8

9 427. The Allowance was reported on the Company’s balance sheet as a reduction to  
10 assets. As loans were “charged off” as losses against the Allowance, the Allowance was reduced.  
11 In order to properly account for the worsening credit quality of its loan portfolio, WaMu was  
12 required under GAAP to record periodic provisions (which WaMu referred to as its “provisions  
13 for loan and lease losses” or its “provision for loan losses”) to increase its reserve to reflect its  
14 estimate of incurred or probable credit losses. Under GAAP, a provision for loan and lease  
15 losses is recorded as an expense, which reduces pre-tax earnings on a dollar-for-dollar basis.  
16 Thus, WaMu’s reported Allowance was directly linked to net income and the Company’s  
17 earnings per share  
18

19 428. However, as explained below, during the Class Period WaMu’s accounting for its  
20 Allowance violated fundamental principles of GAAP and the SEC regulations. Throughout the  
21 Class Period, in furtherance of their efforts to disguise the negative impact that the deteriorating  
22 credit quality of the Company’s home mortgage loans was having on the Company’s financial  
23 condition, WaMu and the Officer Defendants, among other things, improperly accounted for the  
24 impairment of WaMu’s loan portfolio by materially understating WaMu’s provisioning for loan  
25  
26  
27

1 and lease losses, and thereby overstated WaMu's net income and earnings per share and  
2 understated WaMu's Allowance.

3 **1. GAAP and Other Governing Accounting**  
4 **Standards That WaMu Claimed to Follow**  
5 **Established Clear Rules Concerning How**  
6 **WaMu Should Have Reserved for Loan**  
7 **Losses**

8 429. WaMu repeatedly represented that it accounted for its Allowance for its portfolio  
9 of home mortgage loans in accordance with GAAP, and, in particular, Statement of Financial  
10 Accounting Standards No. 5, "Accounting for Contingencies" ("SFAS 5"). SFAS 5, which was  
11 issued over thirty years ago and has been applicable to *every* annual and interim financial  
12 statement *every* public company has issued for *every* fiscal year beginning after July 1, 1978,  
13 states:

14 An estimated loss for loss contingency . . . shall be accrued by a charge to income  
15 if *both* of the following conditions are met:

- 16 a. Information available prior to issuance of the financial statements  
17 indicates that it is probable that an asset had been impaired or a liability  
18 had been incurred at the date of the financial statements. It is implicit in  
19 this condition that it must be probable that one or more future events will  
20 occur confirming the fact of the loss.
- 21 b. The amount of loss can be reasonably estimated.

22 (Emphasis in original.)

23 430. In the context of lending, Statement of Financial Accounting Standards No. 114,  
24 "Accounting By Creditors for Impairment of a Loan" ("SFAS 114"), which was issued in May  
25 1993 – over fifteen years ago – provides a definition of "impairment" for individual loans under  
26 GAAP that is also instructive for pooled loans: "A loan is impaired when, based on current  
27 information and events, it is probable that a creditor will be unable to collect all amounts due  
28 according to the contractual terms of the loan agreement."

431. Further, the American Institute of Certified Public Accountants' (AICPA) *Audit and Accounting Guide for Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies* (the "AICPA Guide"), which was originally issued in 2004 and updated in 2007, instructs that although SFAS 5 indicates that losses should be recognized only once the events causing the losses have occurred, there is an important caveat flowing from that rule: ***"if a faulty credit granting decision has been made or loan credit review procedures are inadequate or overly aggressive . . . the loss should be recognized at the date of loan origination."***

432. These fundamental GAAP provisions underpin the "Expanded Guidance for Subprime Lending Programs," issued by the Agencies in 2001, which several years before the beginning of the Class Period provided guidance specific to reserving for subprime loans:

The [Allowance] required for subprime loans should be sufficient to absorb at least all estimated credit losses on outstanding balances over the current operating cycle, typically 12 months. ***The board of directors and management are expected to ensure that the institution's process for determining an adequate level for the [Allowance] is based on a comprehensive and adequately documented analysis of all significant factors. The consideration of factors should include historical loss experience, ratio analysis, peer group analysis, and other quantitative analysis, as a basis for the reasonableness of the [Allowance].*** To the extent that the historical net charge-off rate is used to estimate expected credit losses, it should be adjusted for changes in trends, conditions, and other relevant factors, including business volume, underwriting, risk selection, account management practices, and current economic or business conditions that may alter such experience. ***The allowance should represent a prudent, conservative estimate of losses that allows a reasonable margin for imprecision.***

433. The SEC also provides direct guidance on the proper accounting for loan losses. SEC Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues" ("SAB 102"), which was issued in July 2001, also several years *before* the Officer Defendants' improper activities at issue here, states in pertinent part: ***"It is critical that loan loss allowance methodologies incorporate management's current judgments about***

1 *the credit quality of the loan portfolio through a disciplined and consistently applied process.”*

2 Therefore, pursuant to SAB 102, a loan loss allowance methodology generally should

3 *“[c]onsider all known relevant internal and external factors that may affect loan collectability .*

4 . . [and] be based on current and reliable data[.]”

5 434. SAB 102 expressly provides that “[f]actors that should be considered in  
6 developing loss measurements” include:

- 7 1. Levels of and trends in delinquencies and impaired loans;
- 8 2. Levels of and trends in charge-offs and recoveries;
- 9 3. Trends in volume and terms of loans;
- 10 4. Effects of any changes in risk selection and underwriting standards, and  
11 other changes in lending policies, procedures, and practices;
- 12 5. Experience, ability, and depth of lending management and other relevant  
13 staff;
- 14 6. National and local economic conditions;
- 15 7. Industry conditions; and
- 16 8. Effect of changes in credit concentrations.

17 As discussed below, the Officer Defendants failed to appropriately take into account the above  
18 factors in provisioning for the Company’s Allowance.

19 435. The SEC further states in SAB 102 that “[f]or many entities engaged in lending  
20 activities, the allowance and provision for loan losses are significant elements of the financial  
21 statements. Therefore, the staff believes it is appropriate for an entity’s management to review,  
22 on a periodic basis, its methodology for determining its allowance for loan losses.” Thus, in  
23 addition to evaluating loans for impairment at origination, lenders are expected to reevaluate  
24 their reserving methodology, and therefore their loans or loan portfolios for impairment, every  
25 financial reporting period thereafter.



436. SAB 102 also approvingly references SEC Financial Reporting Release (“FRR”) 28 §401.9 (“FRR 28”), “Accounting for Loan Losses by Registrants Engaged in Lending Activities,” which was issued in December 1986 – over twenty years ago (and approximately 15 years before SAB 102 was issued). FRR 28 states, in pertinent part, that “[b]ecause the allowance [for loan and lease losses] and the related provision are *key elements of financial statements of registrants engaged in lending activities, it is critical that those judgments be exercised in a disciplined manner that is based on and reflective of adequate detailed analysis of the loan portfolio.*”

437. In addition to the foregoing standards, according to the AICPA Guide, § 9.17:

Loan evaluations by management (and tests of such by independent accountants to the extent they are performed as part of the engagement) should avoid the following:

*Collateral myopia.* This is the failure to see beyond collateral values to a financial weakness in the borrower. . . .

*Inadequate collateral appraisals.* This is the failure to critically review appraisals to understand the methods employed, assumptions made, and limitations inherent in the appraisal process, including undue reliance on management appraisals.

438. Throughout the Class Period, WaMu and the Officer Defendants did not reveal that they were deviating significantly from the requirements of the foregoing accounting standard, and also made materially false and misleading statements about the Company’s Allowance and the methodologies used to review and adjust it. Rather, WaMu represented that it was following appropriate accounting rules and that, among other things, the Company’s management reviewed its models for loan losses for reasonableness, and, on a quarterly basis, updated the assumptions used in those models. In addition, according to the Company’s 2006 Form 10-K, WaMu supposedly generally evaluated for impairment its loans held in portfolio on a collective basis “using statistical forecasting models that estimate default and loss outcomes



1 based on an evaluation of past performance of loans in the Company's portfolio and other factors  
2 as well as industry historical loan loss data." Based on this statistical modeling, the Company  
3 represented, WaMu allocated a certain percentage of its provision for loan losses to its different  
4 loan product categories (*e.g.*, home loans, credit card loans, commercial loans).

5  
6 439. Additionally, the allocated portion of WaMu's Allowance was supplemented by an  
7 unallocated allowance, which, according to WaMu, was supposedly based upon several factors,  
8 including "national and local economic trends and conditions, industry conditions within  
9 portfolio segments, recent loan portfolio performance, loan growth and concentrations, changes  
10 in underwriting criteria, and the regulatory and public policy environment."

11  
12 440. Indeed, as Defendant Killinger trumpeted in a December 13, 2006, conference  
13 call with investors:

14 When we do our reserving, I will tell you that we factor in the existing book of  
15 business; what the current delinquencies are; we make assumptions about housing  
16 price declines and the economy; and we develop models about what we think is  
17 going to happen to delinquencies, ultimate charge-offs. And those things are,  
18 clearly, rising right now. And then we back that into what's the appropriate  
19 amount of embedded losses in that portfolio, and that determines our reserving.  
20 We do that every quarter.

21 441. According to the Company's 2006 Form 10-K, the Finance Committee of the  
22 Company's Board of Directors oversaw the Company's credit risk management activities. The  
23 members of the Finance Committee during the Class Period included Defendants Farrell, Frank,  
24 Lillis, Montoya, Murphy, Osmer-McQuade, Pugh, and Reed. Further, according to the  
25 Company's 2006 Form 10-K, the Company's Enterprise Risk Management committee, which  
26 was chaired by the Company's Chief Enterprise Risk Officer, Defendant Cathcart, was  
27 responsible for "oversee[ing] the identification, measurement, monitoring, control and reporting  
28 of credit, market and operational risks." The Company's 2006 Form 10-K explained that

Enterprise Risk Management works with the lines of business to establish appropriate policies, standards and limits designed to maintain risk exposures within the Company's risk tolerance. Significant risk management policies approved by the relevant management committees are also reviewed and approved by the Board, Audit, and Finance Committees.

As discussed above, CW 18 reported that, in 2005, the Company's Chief Enterprise Risk Officer, James Vanasek (who retired shortly thereafter), expressly informed the Company's credit risk officers that the Company had decided to become more aggressive in its credit provisioning. Thus, the Officer Defendants began under-provisioning WaMu's Allowance at the same time that the Company was secretly causing its loan underwriting standards, appraisal practices, and credit controls to deteriorate.

## 2. WaMu and the Officer Defendants Disregarded Governing Accounting Rules and Standards

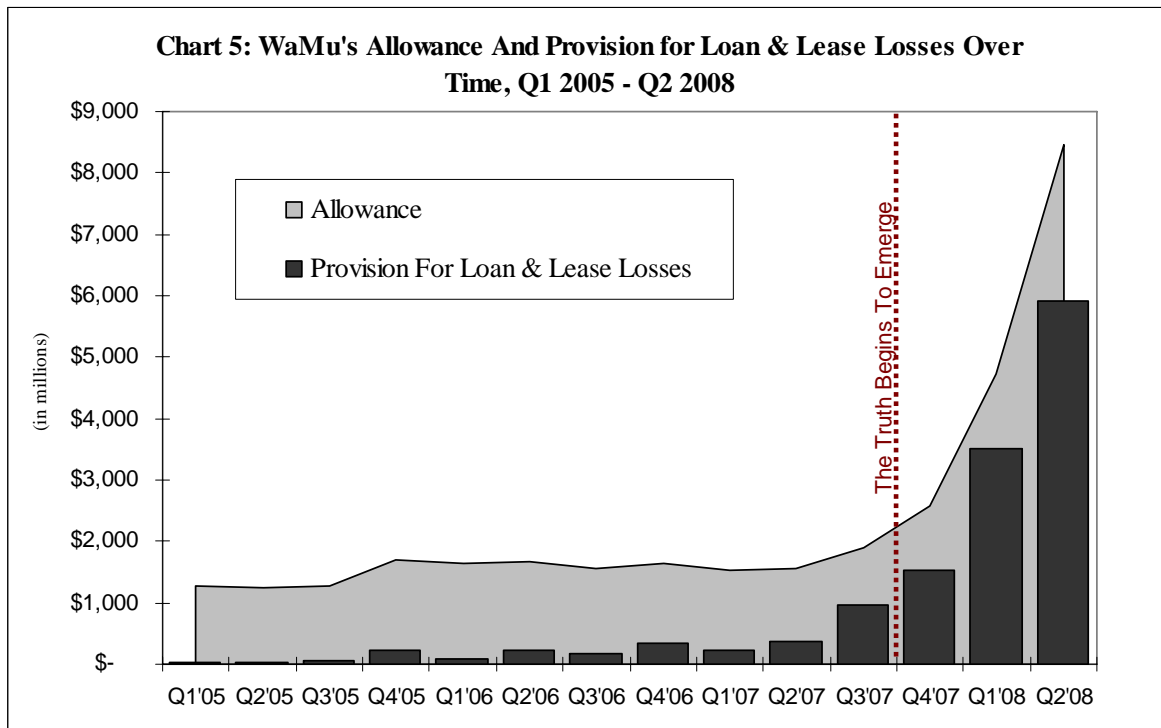
442. Rather than follow appropriate accounting standards for its Allowance, the Company failed to apply even the most rudimentary of GAAP's provisions or to follow the SEC's guidance, as explained in SAB 102 and by the agencies through their guidance. Indeed, the Company repeatedly failed to increase its provisioning of its Allowance in light of "levels of and trends in delinquencies and impaired loans . . . trends in volume and terms of loans . . . [and] effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices," as it was required to do.

443. As the Officer Defendants knew, during the Class Period, WaMu had, among other things: (1) significantly loosened its underwriting guidelines; (2) encouraged wholesale exceptions to those loosened guidelines through explicit emphasis on loan quantity over quality; (3) compensated its employees based upon loan volume without regard to borrowers' credit quality; (4) pressured appraisers (initially its in-house appraisers and then its outside appraisers) to inflate the appraisal value of the underlying collateral of its loans, thereby undermining the

1 entire foundation for evaluating the credit quality of its loan portfolio; and, (5) relegated its credit  
2 risk management to an optional, “consultative” role, rather than the gatekeeping function it was  
3 supposed to provide.

4 444. Because of these facts, which were known to the Officer Defendants (but  
5 concealed from the investing public) the Officer Defendants were required under GAAP and  
6 SEC guidelines to increase the Company’s provisioning for its Allowance in a manner  
7 commensurate with the decreasing credit quality of WaMu’s home mortgage products. Instead,  
8 the Officer Defendants, in order to conceal their activities and to inflate the Company’s reported  
9 net income, maintained the Company’s provisioning at a level more appropriate for a loan  
10 portfolio made up of loans unimpaired by the practices and problems detailed above.

11 445. Thus, in violation of SFAS 5, SFAS 114, SAB 102 and the AICPA Guide, the  
12 Company did not factor in the “effects of any changes in risk selection and underwriting  
13 standards, and other changes in lending policies, procedures, and practices” when provisioning  
14 for its Allowance. Rather, the Officer Defendants ignored underwriting quality and the quality of  
15 the underlying collateral for its loans. As shown in Chart 5 below, this resulted in a shocking  
16 increase very late in the Class Period of the Company’s provisioning levels in the third and  
17 fourth quarters 2007 and beyond:  
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As Chart 5 indicates, the Company's Allowance was suppressed during most of the Class Period (after taking into account the increase during the fourth quarter of 2005 associated with the Company's acquisition of Provident, a large credit card company) until the truth about the Company began to emerge. The stable and relatively low levels of the Allowance before the truth about WaMu's loan quality began to emerge further helped create the appearance of a healthy loan portfolio at WaMu and that WaMu's provision for loan and lease losses was appropriately calculated to replenish the Allowance as loan charge-offs depleted the Allowance. However, WaMu's deteriorated underwriting standards and unlawful appraisal practices had caused WaMu to hold for investment a large amount of substandard loans that were, in effect, time bombs that the Company and the Officer Defendants knew were bound to "explode," particularly WaMu's signature Option ARM loans. In the third quarter of 2007, the Company could no longer continue to hide the impairment of the loans it held and had no choice but to

1 finally begin to increase its Allowance - the resulting impacts continued to be felt by investors  
2 well into 2008.

3 446. Further, as discussed in detail below, as early as *September 2005*, WaMu and the  
4 Officer Defendants knew or were reckless in disregarding that WaMu's Loan Performance Risk  
5 Model (the "LPRM") – the "fundamental" model whereby the Company calculated the  
6 appropriate provision for the Allowance – *did not account for and did not accurately predict the*  
7 *financial impact of recognized material risk factors concerning WaMu's loan portfolio.*  
8 However, as explained below, WaMu and the Officer Defendants did not disclose or act to finally  
9 correct these issues for at least *nine months* after the problems with the LPRM were fully  
10 documented and reported internally at WaMu. In addition, WaMu and the Officer Defendants  
11 did not appropriately adjust WaMu's LPRM periodically to take into account the actual,  
12 undisclosed deteriorating performance of the Company's loan portfolio during the Class Period,  
13 as they should have.  
14

15 447. The deterioration of the credit quality of WaMu's loans was neither outside of the  
16 Company's control nor was it unforeseeable to management. Indeed, the opposite is true: WaMu  
17 increasingly underwrote high-risk loans with loose underwriting standards and inflated  
18 appraisals, which it knew were impaired, while under-provisioning its Allowance. Further, the  
19 Officer Defendants knew, or were reckless in not knowing, that the LPRM did not incorporate  
20 certain basic and key assumptions regarding WaMu's loans. The Officer Defendants ignored  
21 clear impairment indicators of WaMu's loans both at the point of origination and during  
22 subsequent reporting periods, causing its reported financial position and results to be materially  
23 misstated throughout the Class Period in violation of GAAP and the other authorities referenced  
24 above.  
25  
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a. **Defendants Knowingly Failed to Appropriately Account for the Company's Option ARM Loans in Provisioning for WaMu's Allowance**

448. As discussed at ¶¶330-375, the Officer Defendants repeatedly downplayed the risk inherent in WaMu's Option ARM portfolio by, among other things, falsely stating that the loans were underwritten to their fully-indexed rate and that the LTV ratios for WaMu's loans, which as explained above were directly related to the appraisal values of the homes that were the collateral for WaMu's loans, offered the Company a sufficient cushion against loan default. However, as internal, non-public documents that WaMu attempted to shield from outside scrutiny reveal, the Officer Defendants were knowingly failing to reserve at the appropriate rates for WaMu's Option ARM loans, the largest component of WaMu's held for investment portfolio.

449. The Company's 2006 Form 10-K (and in substantially similar language, the Company's 2005 Form 10-K) claimed that, in evaluating the loan performance of its Option ARM loans in order to determine appropriate reserves for incurred losses, the Company took into account "[t]rends in loan performance and risk attributes such as loan-to-value ratios, credit scores, *negative amortization*, minimum payment adjustments, degree of minimum payment utilization, and geographic concentrations[.]"

450. However, an internal, non-public document obtained through Lead Plaintiff's investigation reveals that, as of September 2005, the Officer Defendants were aware that the Company was not accurately assessing the risk of the Company's Option ARM loans. This document was dated September 2005 and entitled "Corporate Risk Oversight Report: Allowance for Loan & Lease Losses Methodology of Washington Mutual Bank." (the "CRO Report") The CRO Report, not including its cover sheet, is fourteen pages and consists mostly of single-spaced text. On each page, the document is marked "**Confidential**: The contents of this report are for

1 internal management purposes only and are not to be disclosed except to those persons who  
 2 require the information in the performance of their duties.” (Emphasis in original.) The CRO  
 3 Report described the objectives of the report as follows:

4 Corporate Risk Oversight (CRO) has conducted a process review of the  
 5 [Allowance]. The review focused on the evaluation of the following elements:

- 6 • [Allowance] model assumptions and controls[.]
- 7 • [Allowance] governance,
- 8 • [Allowance] documentation and supporting policies[.]

9 451. The CRO Report states that the “goal of the [Allowance] team is to forecast  
 10 *expected losses over the upcoming four years[.]*” (Emphasis in original.) The results of  
 11 WaMu’s internal review of the methodologies that WaMu used to establish its Allowance, as  
 12 revealed in the CRO Report, are damning.

13 452. The CRO Report details many alarming deficiencies concerning WaMu’s  
 14 Allowance methodology and other management and operational issues. Several of these  
 15 material problems are explained in connection with the Complaint’s discussion of WaMu’s  
 16 deficient internal controls, below; however, perhaps the most alarming finding in the CRO  
 17 Report, which the CRO Report mandated required to be “presented to management in writing”  
 18 and for which the CRO Report requested “management to provide a written response” because of  
 19 its grave implications concerned WaMu’s LPRM. Specifically, the CRO Report revealed that  
 20 WaMu’s loss model was materially deficient:

21 **The predictive performance of *Loan Performance Risk Model (LPRM)* is**  
 22 **untested on products with the potential to negatively amortize. Given recent**  
 23 **production and interest rate trends, negative amortization is a major and**  
 24 **growing risk factor in our portfolio.**

25 453. In other words, WaMu’s LPRM, the model upon which the Company estimated  
 26 the credit losses for the loans in its portfolio and based its Allowance, did not account for the  
 27

1 performance of the Company's Option ARM loans, which the Company knew to be generally  
2 high-risk loans.

3 454. In response to the CRO Report, on November 1, 2005, WaMu management  
4 submitted a written "Review Response" from Joe Matthey, Senior Vice President of Portfolio, to  
5 "Corporate Risk Oversight," with a carbon copy to James Vanasek, Chief Enterprise Risk  
6 Officer; Hugh Boyle, Chief Risk Officer; and Melissa Martinez, Chief Risk Oversight Officer  
7 and Chief Compliance Officer (the "CRO Report Response"). The CRO Report Response was  
8 marked "Confidential – Internal Use Only" on each page by WaMu.

9  
10 455. Concerning the significant defects identified in WaMu's LPRM, the CRO Report  
11 Response admitted that:

12 [T]he documentation of the validation of LPRM did not provide a specific  
13 analysis of the ability of LPRM to reflect the higher risks of potentially negatively  
14 amortizing loans as distinct from loans without such potential. And, that  
15 documentation did not specifically analyze the ability of this model to reflect how  
16 losses might increase on Option ARM and Flex loans as interest rates increase.

17 456. To respond to this known hazard, the CRO Report Response prepared by WaMu's  
18 management simply stated that the LPRM would be "enhanced," with a target completion date of  
19 *June 30, 2006 – an amazing nine months after the Allowance methodology deficiencies were  
20 identified and documented in writing in the CRO Report.*

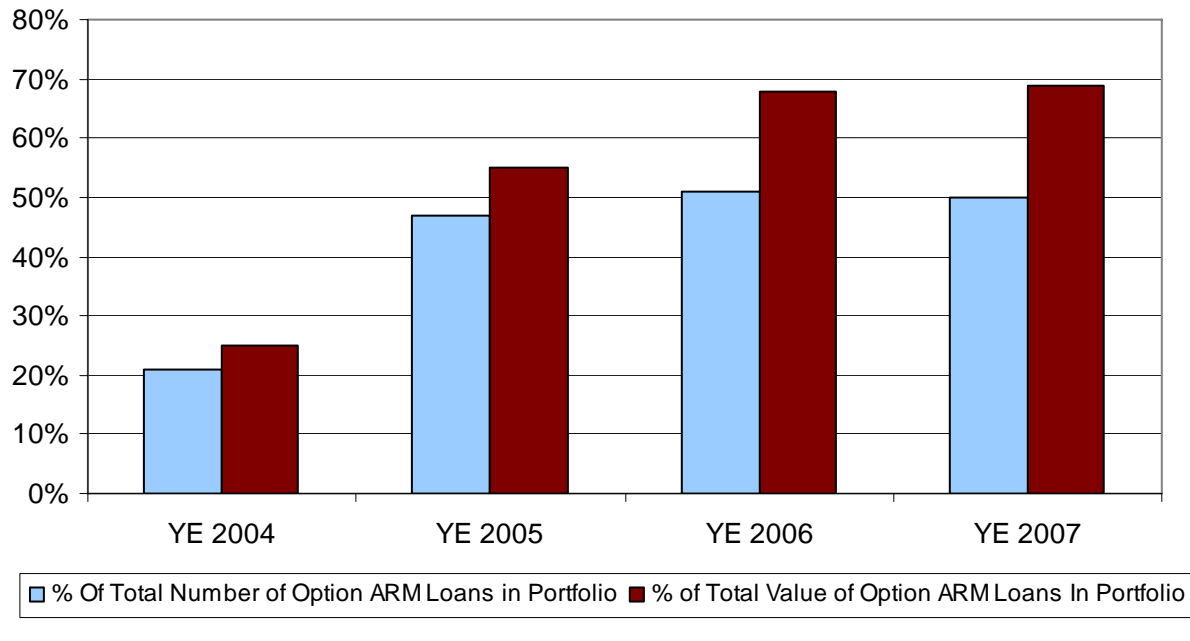
21 457. Notwithstanding the fact that WaMu did not have a functioning model in place to  
22 evaluate the Company's risk of loss from loans with the potential to negatively amortize (e.g.,  
23 WaMu's Option ARM loans), the Company maintained and even increased the proportion of  
24 Option ARM loans in its home loan portfolio without adjusting its Allowance appropriately.  
25 Indeed, as discussed *supra* in Section VI.D, the Company encouraged its salespeople and  
26 mortgage brokers with whom the Company worked to sell ever greater numbers of Option ARM  
27 loans through bonus incentives. As noted above in ¶74, Chart 1, Option ARM loans dominated



1 WaMu's single-family residential portfolio from the fourth quarter 2005 throughout the Class  
2 Period.

3 458. Indeed, growing rates of negative amortization on the Company's Option ARM  
4 loans should have required the Officer Defendants to, at a minimum, materially increase the  
5 Allowance, even if only through the unallocated portion of the Allowance, during the Class  
6 Period, especially given the increased risks admittedly related thereto by WaMu. During the  
7 Class Period, as the Officer Defendants knew, many borrowers were only making the minimum  
8 payments on Option ARMs, meaning that they were not even paying the then currently-due  
9 interest. Thus, during the Class Period, WaMu recorded significant amounts of negative  
10 amortization (*i.e.*, the difference between the payment made and the full payment to pay all  
11 interest due) from Option ARMs as deferred revenue (*i.e.*, interest income) and, correspondingly,  
12 increased the balance due on negatively-amortizing loans. In fact, the number of WaMu's Option  
13 ARM borrowers who were paying less than the amount necessary to pay currently-due interest  
14 and principal of their loans increased steadily during the Class Period, both as a percentage of  
15 total loans in WaMu's portfolio and as a percentage of the total value of the loans in WaMu's  
16 portfolio, as illustrated by Chart 6 below.  
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**Chart 6: WaMu's Option ARM  
Borrowers in Negative Amortization**

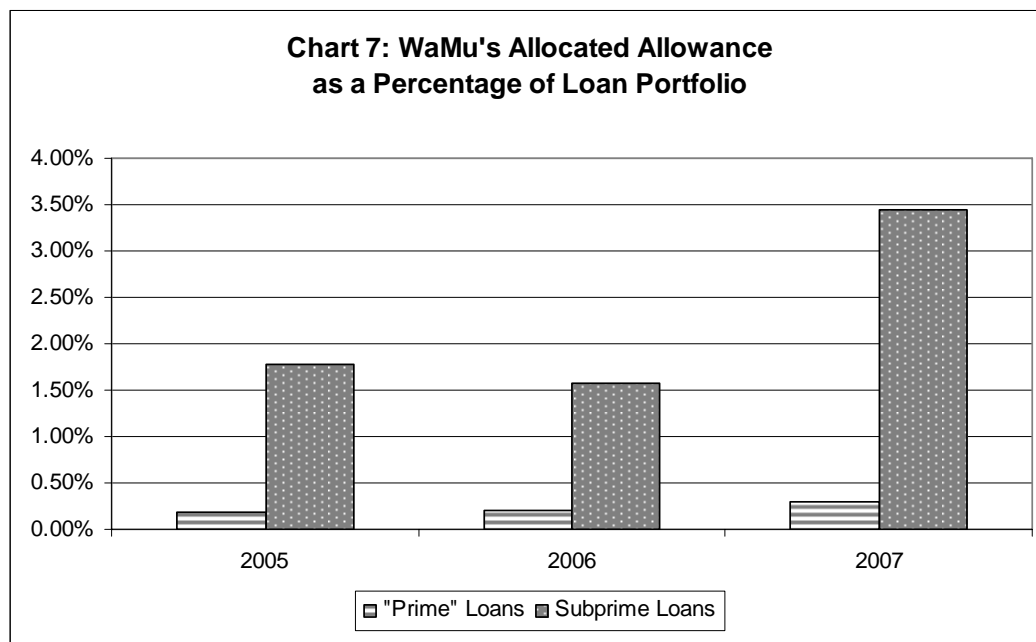


459. While the reported increase in interest income from negative amortization presented the impression that the Company's results were strong, in fact, the enormous accumulated negative amortization on these loans was a red flag to the Officer Defendants that those loans were trending towards delinquency and default. Moreover, as soon as WaMu's Option ARM borrowers reached the specified, pre-set negative amortization caps, which would force them to start fully repaying the loan, those borrowers, who then owed substantially more than they had initially borrowed, were at even greater risk of failing to make their loan payments.

460. However, WaMu and the Officer Defendants did not appropriately address the dangerous nature of WaMu's Option ARM loans when determining and allocating the Company's Allowance. As WaMu knew, its Option ARM loans performed much more similarly to the Company's subprime portfolio than to standard prime loans. For example, between 2006 and 2007, the percentage increases in net charge-offs in the Company's non-subprime loans

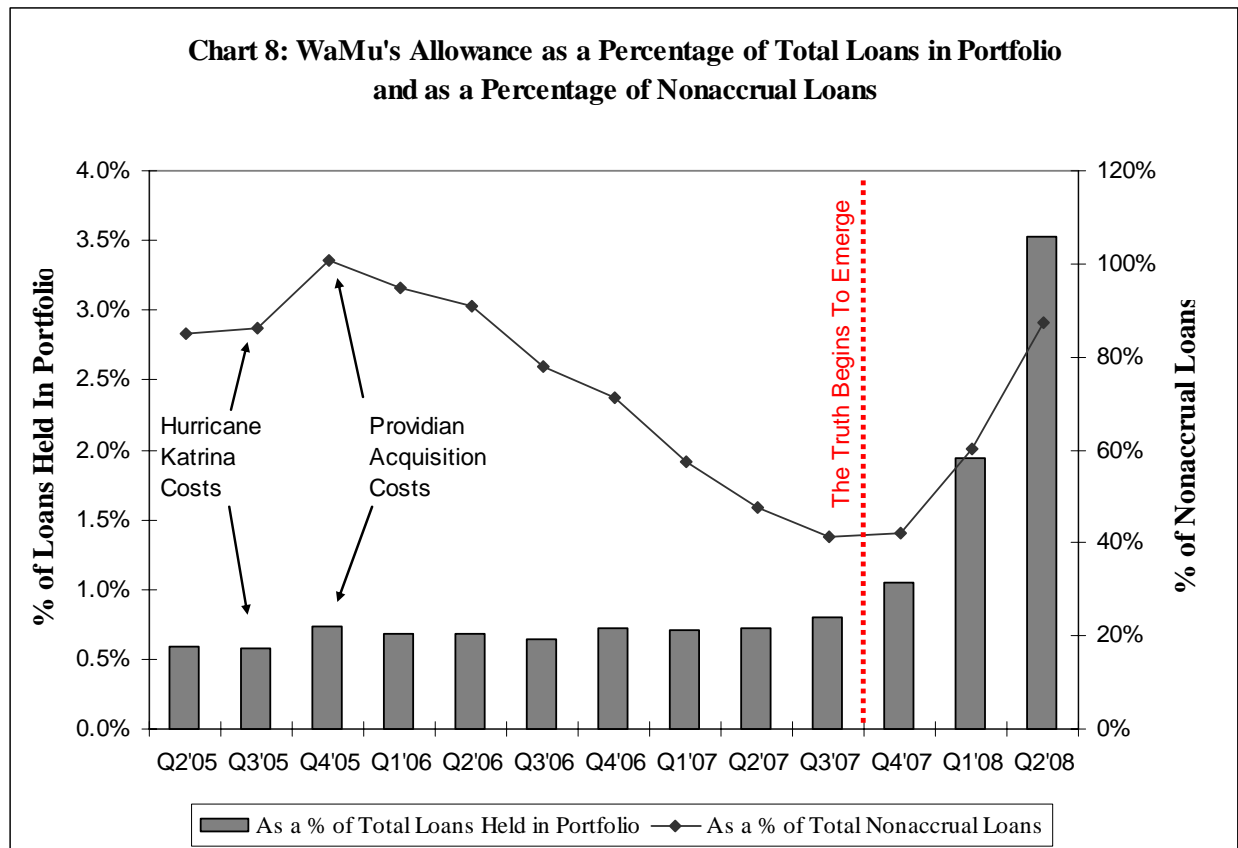
(including Option ARM loans) and the Company's subprime loans were 420% and 432%, respectively. However, rather than provisioning for Option ARM loans (and other so-called "prime" WaMu loans) at a rate similar to that for the Company's subprime portfolio, the Officer Defendants evaluated them for impairment as part of their prime Home Loans portfolio and provisioned for Option ARM loans at a much lower rate.

461. Likewise, although Option ARMs comprised over half of the Company's so-called "prime" loan portfolio throughout the Class Period, the allowance allocated to the prime loan portfolio was disproportionately low. As illustrated in Chart 7 below, in 2007, WaMu's Allowance allocated to the entire home loans category was \$322 million, or 0.29% percent of the value of the prime loan category. This percentage contrasts sharply with the allocated Allowance for the subprime channel, which, while inadequate, was \$643 million, or 3.45% of the value of the subprime loan category in 2007.



**b. The Deteriorating Quality of WaMu's  
Loans Also Indicates that WaMu's  
Allowance For Loan & Lease Losses Was  
Materially Understated Throughout the  
Class Period**

462. In violation of SAB 102, the Officer Defendants did not adequately consider the Company's "levels of and trends in delinquencies and impaired loans" in provisioning for loan losses. As confirmed by the Company's reported loan delinquencies, and by numerous confidential witnesses, which are discussed above in Sections VI.B, VI.C, and VI.D, the quality of the Company's loan portfolio was steadily worsening over time. The deteriorating quality of WaMu's loans is illustrated by the rising number of "nonaccrual loans," or home mortgage loans that were over ninety days past due on payments. Instead of increasing the Allowance in compliance with GAAP and SEC guidelines to properly account for the rapidly deteriorating quality of WaMu's loan portfolio, beginning in the third quarter of 2005, the Officer Defendants actually *decreased* the Allowance relative to the number of nonaccrual loans that were accumulating in the Company's portfolio. This contrast is illustrated in Chart 8, below. While the third and fourth quarters of 2005 show an increase of the Allowance as a percentage of nonaccrual loans, during those two quarters the Company experienced one-time events, unrelated to WaMu's loosened underwriting standards and overstated appraisals, that increased WaMu's provisioning for those two quarters. Specifically, in the third quarter 2005, \$37 million of the \$52 million provision, or over 70%, consisted of Hurricane Katrina-related costs. Similarly, in the fourth quarter 2005, the Company accounted for the acquisition of Providian, a credit card company, by increasing the provision dramatically; that quarter, \$195 million, or over 60%, of the \$316 million provision related to that acquisition. While the Providian acquisition may have continued to influence the provisioning of reserves in early 2006, the effect was *de minimis* compared to the substantial additional provision in the fourth quarter of 2005.



463. In further violation of SAB 102, the Officer Defendants did not appropriately consider the Company's "levels of and trends in charge-offs and recoveries" in provisioning for the Allowance. Incredibly, as discovered through Lead Plaintiff's investigation, the Company's fundamental model for calculating the appropriate level at which to provision the Allowance, in addition to its other defects that were known to WaMu and the Officer Defendants that were set forth in the CRO Report, WaMu's LPRM *was not calibrated to reflect actual loan performance*. Confidential Witness 78, who served as an Assistant Vice President / Analyst II in the Risk Analytics Group at WaMu from January 2006 until January 2008, discovered this fact during the summer of 2007 when CW 78 worked on a project analyzing the credit parameters of new loans that were considered to be the highest risk loans.

1           464. In connection with that research, CW 78's analyst team decided to use WaMu's  
2 LPRM, which, as CW 78 recalled, was a "key tool" in calculating the Allowance's requirements.  
3 In CW 78's project, this analysis was then correlated with actual performance data for different  
4 groups of loans over comparable periods. The goal of the exercise was to examine expected  
5 losses for these riskiest of loans.

6  
7           465. However, CW 78 explained that when the analyst team performed regression  
8 analyses of the data using the LPRM as a predictive tool, the LPRM clearly "showed a level of  
9 'charge-offs' that was lower than the actual historical data." According to CW 78, the LPRM  
10 consistently understated loan delinquency when held up to WaMu's actual empirical data. When  
11 CW 78 questioned why the LPRM consistently produced such problematic results, CW 78 was  
12 informed that *the LPRM had not been calibrated for almost eighteen months to reflect actual*  
13 *loan performance data.*

14  
15           466. The consequences of this failure were devastating. During the Class Period, in  
16 addition to the increases in nonaccrual loans, the Company's charge offs and foreclosed assets  
17 also steadily increased. For example, net charge-offs in home mortgage loans increased from  
18 \$36 million in the third quarter of 2005, to \$166 million as of June 30, 2007, and then to \$1.97  
19 billion in the second quarter of 2008. Similarly, foreclosed assets increased from \$256 million in  
20 the third quarter of 2005, to \$330 million as of June 30, 2007, and then to \$1.156 billion in the  
21 second quarter of 2008. Furthermore, as discussed by numerous percipient witnesses, both first  
22 payment defaults (defined above as "FPDs") and early payment defaults ("EPDs") were a  
23 growing and alarming problem for the Company throughout the Class Period. The LPRM, the  
24 Company's fundamental model for calculating the appropriate levels at which to provision the  
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1 Allowance, simply failed to take into account all loan performance data from the winter of 2005  
2 onward – precisely when the loans broadly began to fail.

3 **3. The Company's GAAP Violations**  
4 **Resulted in Materially Misstated**  
5 **Financial Statements**

6 467. In addition to the trends evident in the rising rate of nonaccrual loans, net charge-  
7 offs, and negative amortization from quarter to quarter, the Officer Defendants were aware that  
8 the credit quality of the remainder of WaMu's loan portfolio was rapidly deteriorating as a result  
9 of, among other things, the Company's loosened underwriting standards and the use of inflated  
10 appraisals in the credit review process. The insufficiency of the Officer Defendants'  
11 provisioning for loan losses was partially disclosed in the third quarter of 2007, when the  
12 Company suddenly announced guidance for its fourth quarter loan loss provision of \$1.1-\$1.3  
13 billion. The actual loan loss provision for the fourth quarter of 2007, as announced by the  
14 Company on January 17, 2008, was over \$1.5 billion – a quarterly provision greater than the  
15 2007 full-year provision publicly projected by the Company at the beginning of that year.

16 468. According to an analysis of publicly-available information, the amount by which  
17 the Officer Defendants under-provisioned the Company's Allowance during the Class Period was  
18 massive. In each of the six quarters prior to the Class Period, the Company maintained its  
19 Allowance at no less than 81.58% of the Company's total nonaccrual real estate loans. During  
20 the Class Period, the Officer Defendants drastically reduced the Company's Allowance as a  
21 percentage of nonaccrual loans to a low of 41.27%. Because the Officer Defendants caused the  
22 Company to weaken its underwriting guidelines, the Allowance as a percentage of nonaccrual  
23 loans should have been increased, rather than reduced, during the Class Period. Even assuming  
24 the proper Allowance level as a percentage of delinquencies during the Class Period was the  
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1 historic low of 81.58% in the first quarter 2005 (although it should have been higher because the  
 2 Company had substantially deviated from its underwriting standards and engaged in improper  
 3 appraisal practices during the Class Period), the amount of the Allowance understatement – and  
 4 corresponding manipulation of publicly-reported income – is set forth in Chart 9 below.

<b>Chart 9 : Minimum Amount By Quarter By Which WaMu's Allowance Was Under-Provisioned</b>	
<b>Quarter</b>	<b>Deficiency (Overage)</b>
<b>Q1'06</b>	<b>\$90,000,000</b>
<b>Q2'06</b>	<b>\$60,000,000</b>
<b>Q3'06</b>	<b>\$241,000,000</b>
<b>Q4'06</b>	<b>\$171,000,000</b>
<b>Q1'07</b>	<b>\$398,000,000</b>
<b>Q2'07</b>	<b>\$472,000,000</b>
<b>Q3'07</b>	<b>\$733,000,000</b>
<b>Q4'07</b>	<b>\$579,000,000</b>
<b>Q1'08</b>	<b>(\$755,000,000)</b>
<b>Q2'08</b>	<b>(\$2,219,000,000)</b>

14 Chart 9 indicates that, under this conservative analysis, the Company actually *over provisioned*  
 15 in the first and second quarter of 2008. This results from the Company's increasingly massive  
 16 "catch up" provisions beginning in the third quarter of 2007. If the Company had been  
 17 provisioning at appropriate levels throughout the Class Period, such as maintaining its  
 18 Allowance at 81.58% of nonaccrual loans throughout the Class Period, then the Allowance  
 19 would have already been at a more appropriate level to address the Company's ongoing losses,  
 20 and the Company would not have had to suddenly and dramatically increase its Allowance.

22 469. As discussed above in ¶462, during the third and fourth quarters of 2005, the  
 23 Company reported special one-time events (Hurricane Katrina-related costs and the acquisition  
 24 of the Company's credit card operations, respectively) that make it impossible to determine, from  
 25 publicly-available information, how much the Officer Defendants were actually under-  
 26



1 provisioning the Allowance for those two quarters. However, as the Officer Defendants'  
2 misconduct with regard to its risk management, underwriting, and appraisal practices began in  
3 the third quarter 2005, upon information and belief, the Allowance was materially understated  
4 for the third and fourth quarter 2005, as well.

5  
6 470. As indicated by Chart 9 above, the Officer Defendants understated the Company's  
7 Allowance by tens or hundreds of millions of dollars in each quarter and billions of dollars in  
8 total. The understatement of the Allowance had a dollar-for-dollar impact on the Company's  
9 reported pre-tax income during the Class Period. (The effect on net income would be reduced by  
10 the Company's effective tax rate.) Thus, the Company reported misleading income amounts  
11 during each quarter of the Class Period in violation of GAAP.

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13 471. As a result of the Officer Defendants' manipulation of the Company's Allowance,  
14 WaMu reported artificially inflated net income in each quarter during the Class Period. Chart 10  
15 shows the net effect, by quarter, of the Officer Defendants' minimum manipulation of the  
16 provision for loan and lease losses on the Company's publicly reported net income. The  
17 manipulation of the Company's reserves is shown on a non-cumulative basis for each quarter  
18 (*i.e.*, the understatement in a particular quarter is not included in subsequent quarters.) Because  
19 the Officer Defendants had caused the Company to diminish its underwriting standards and to  
20 inflate appraisals during the Class Period, WaMu should have increased its reserves during the  
21 Class Period to take into account the lower credit quality of its home loan portfolio. Thus, the  
22 table sets forth an extremely conservative analysis of the overstatement of the Company's net  
23 income manipulation based on the extremely conservative assumptions set forth in ¶468.  
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**Chart 10: Estimated Effect of the Officer Defendants'  
Allowance Manipulation on Net Income\***

<b>Reporting Period</b>	<b>Net Income Reported</b>	<b>Minimum Allowance Understatement</b>	<b>Effect on Net Income</b>	<b>% Difference</b>
1Q'06	\$985,000,000	(\$90,000,000)	(\$33,000,000)	3%
2Q'06	\$767,000,000	(\$60,000,000)	(\$49,000,000)	6%
3Q'06	\$748,000,000	(\$241,000,000)	(\$157,000,000)	21%
4Q'06	\$1,058,000,000	(\$171,000,000)	(\$110,000,000)	10%
1Q'07	\$784,000,000	(\$398,000,000)	(\$164,000,000)	21%
2Q'07	\$830,000,000	(\$472,000,000)	(\$265,000,000)	32%
3Q'07	\$186,000,000	(\$733,000,000)	(\$592,000,000)	318%
4Q'07	(\$1,867,000,000)	(\$579,000,000)	(\$291,000,000)	16%

*\*Quarterly effective tax rate calculated from annual tax rates disclosed in the Company's Form 10-K for year ending December 31, 2007.*

472. Accordingly, during the Class Period, WaMu's Allowance was materially misstated in violation of GAAP and SEC guidelines. The Company's Allowance failed to take into account the adverse performance of WaMu's loans due to the deteriorating underwriting standards and false appraisals for those loans. Thus, the Officer Defendants violated GAAP and ultimately caused the Company to understate its liabilities and overstate its reported net income.

473. Sharon Sabba Fierstein, a Certified Public Accountant with over twenty years of accounting experience (including significant mortgage financing and audit management experience) has been retained by Lead Counsel in connection with Lead Plaintiff's investigation to evaluate WaMu's accounting practices. Ms. Fierstein's opinion concerning WaMu's accounting practices is attached as Appendix 5 (the "Fierstein Declaration"). As explained in the Fierstein Declaration, for nearly ten years, Ms. Fierstein served as the Executive Vice President, Treasurer and Chief Financial Officer of a mortgage banking company. Prior to that, Ms. Fierstein was an Audit Manager for Deloitte Haskins & Sells (a predecessor of Deloitte &

1 Touche LLP), which included a two-year special assignment where she served as Secretary to the  
2 International Auditing Practices Committee for the International Federation of Accountants. In  
3 that position, Ms. Fierstein contributed to the design and drafting of International Auditing  
4 Guidelines and other technical papers. Additionally, Ms. Fierstein is currently the President of  
5 the New York State Society of CPAs and serves as a council member as a New York State  
6 delegate to the American Institute of CPAs. Ms. Fierstein's Curriculum Vitae is attached to  
7 Appendix 5. Having analyzed various publicly-available information concerning WaMu and  
8 having reviewed the information in this Complaint (including the internal WaMu documents  
9 referred to in this Complaint), as set forth in greater detail in her Declaration, it is Ms. Fierstein's  
10 opinion that WaMu materially under-provisioned its Allowance during the Class Period in a  
11 manner that is inconsistent with GAAP and SEC guidelines, and that WaMu lacked adequate  
12 internal controls during the Class Period.  
13  
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15 **4. During the Class Period, the Company's**  
16 **Internal Controls Over Financial**  
17 **Reporting Were Ineffective**

18 474. The Officer Defendants concealed the inadequacy of WaMu's internal controls  
19 throughout the Class Period by falsely representing to investors that the Company's internal  
20 controls over financial reporting were effective. As discussed below in Section VIII, throughout  
21 the Class Period, Defendants Killinger and Casey each repeatedly and falsely certified the  
22 design, operation and effectiveness of WaMu's internal controls in the Company's annual and  
23 quarterly financial statements. However, the Company's purported control environment failed to  
24 ensure that the financial statements issued during the Class Period were reliable or in compliance  
25 with applicable laws. Rather, the Officer Defendants focused on increasing loan volume  
26 origination without regard to the quality of such loans in an effort to reach aggressive market  
27

1 share goals without taking the steps required under GAAP and SEC guidelines to account  
2 properly for their activities. The control environment shaped by the Officer Defendants –  
3 including its sidelining of WaMu’s Risk Management segment – resulted in ineffective internal  
4 controls with respect to the Company’s financial reporting process and allowed the Officer  
5 Defendants to misstate materially the Company’s financial statements.

6  
7 475. The lack of effective internal controls enabled the Officer Defendants to lower  
8 WaMu’s underwriting standards to such a point that it issued high-risk loans including Option  
9 ARM, Alt-A, and subprime loans without determining whether and to what extent the borrowers  
10 could actually repay the loans. Additionally, the lack of effective internal controls allowed senior  
11 management and others at WaMu to pressure in-house and third-party appraisers into inflating  
12 the value of the underlying collateral of the Company’s loans. As discussed above, because of  
13 WaMu’s ineffective internal controls over financial reporting, the Company did not appropriately  
14 account for the credit risk inherent in the Company’s massive portfolio of Option ARM loans.

15  
16 476. Further, WaMu’s ineffective internal controls over financial reporting allowed the  
17 Company to ignore the growing trends of delinquent loans when modeling for its Allowance.  
18 The CRO Report detailed a number of other ways, beyond WaMu’s failure to address the  
19 fundamental aspects of Option ARM loans in its Allowance methodology (and specifically, in the  
20 Company’s LPRM), that WaMu’s Allowance methodology and other controls critical to WaMu’s  
21 financial reporting were dangerously unsound well into the Class Period. Many of these issues  
22 relate directly to senior management’s oversight of the Allowance methodology. Although  
23 designated by the CRO Report as matters requiring “[u]rgent management attention and  
24 aggressive corrective actions” and “prompt attention,” the Company did not propose to address  
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many of the fundamental defects addressed in the CRO Report until the end of March 2006 – *at the earliest*.

477. For example, the CRO Report observes that:

The LPRM does not adequately account for justification for the unallocated allowance. Specific limitations noted in Q2 2005 for LPRM include:

- *payment shock to Flex and Option ARM borrowers* if Fed Funds Rate continues to increase
- *negative amortization potential of Home Loans portfolio*
- the increasing concentration of speculative buyers in the housing market
- decreasing portfolio collateral improvements through a shift in borrower behavior from loans emphasizing debt amortization to one of managing payment terms and cash flow
- Regulator-imposed constraints on more exotic loan products which could reduce liquidity in the housing market.

As noted above, the unallocated portion of WaMu's Allowance was based upon factors including "national and local economic trends and conditions, industry conditions within portfolio segments, recent loan portfolio performance, loan growth and concentrations, changes in underwriting criteria, and the regulatory and public policy environment." WaMu's failure to document justifications for the unallocated portion of the Company's Allowance, the CRO Report suggests, increases "improper use of the models, or incomplete assessment of the unallocated portion[.]"

478. Further, the CRO Report states under the subject of "Management Oversight & Reporting" that the groups responsible for maintaining internal controls lacked even adequate guidelines to accomplish their oversight functions:

The Credit Reserves Committee has been established for the purpose of providing oversight of the reserve and provisioning methodologies, models, assumptions, and more, yet guidelines detailing how this is to be accomplished are not available.

Furthermore, the Loss Modeling Working Group, responsible for providing reports and analysis to aide the Committee in determining the adequacy of the [Allowance], lacks formal guidelines for this process.

479. In addition, the CRO Report goes on to provide “additional detail” regarding this failure, explaining that WaMu’s internal control failures meant that in addition to lacking effective guidelines, WaMu’s Credit Reserves Committee was not being provided with sufficient information to discharge it duties – which jeopardized compliance with GAAP and Agency guidance:

Failure to provide the Committee with specific information and data (including adjustments, assumptions, changes/adjustments in methodology, etc.) and comparison over an extended period of time (not only quarter-to-quarter) could result in decisions without adequate analysis, or decisions based on quarterly minutiae rather than long-term trends and performance. The process of determining reserve adequacy would also be adversely impacted if the Committee does not include representatives with significant and specific knowledge of each of the portfolios reviewed.

The Committee should be provided with information that is robust enough, covering a prolonged period of time, to ensure that all the risks have been surfaced and thoroughly vetted in determining the adequacy of reserves for the bank and individual loan portfolios. The information must include the underlying assumptions made throughout the process, allowing management to regularly challenge and adjust the assumptions to reflect changes in the portfolios’ risk characteristics. A method should be included to track any changes made from period to period and historically, preventing significant deviation from the expected evolution of the process. Furthermore, the standards and guidelines should ensure that the Committee consists of appropriate subject matter expertise relative to each of the business models or portfolios being reviewed. ***This would help comply with Interagency Guidance which calls for verification and review for GAAP conformance and supervisory guidance by a party independent from the [Allowance] estimation process.***

The CRO Report therefore “strongly” recommended that the Company take steps toward addressing these glaring inadequacies by establishing “formal standards and guidelines” for the Credit Reserves Committee and the Loss Modeling Working Group, including “what types of reporting and analyses [are] necessary for sufficiently determining the adequacy of the reserves.” The CRO Report emphasized that such guidelines are “essential in providing transparency in the [Allowance] process, both internally and externally.” Shockingly, the CRO Report Response

1 prepared on behalf of WaMu's management proposed to respond to the issues related to  
2 "Management Oversight & Reporting" by March 31, 2006. Yet, WaMu and the Officer  
3 Defendants never revealed these shocking failures of internal controls to the investing public.

4 480. Because of management's failure to maintain effective internal controls over  
5 financial reporting, as discussed above at ¶¶474-481, WaMu and the Officer Defendants were  
6 able to conceal the deteriorating condition of WaMu's loan portfolio from the investing public by  
7 not provisioning for its Allowance in a manner appropriate for such a poor-quality loan portfolio  
8 and to materially misstate the Company's assets and earnings.

9 481. Management's assessment of internal controls over financial reporting was a  
10 critical statement for investors because it provided (false) assurance that the Company's financial  
11 statements were reliable and in compliance with applicable laws. However, during the Class  
12 Period, WaMu did not properly assess its internal controls over financial reporting.

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15 **VII. ADDITIONAL ALLEGATIONS CONFIRMING**  
16 **THE OFFICER DEFENDANTS' SCIENTER**

17 482. At all relevant times, the Officer Defendants acted with scienter in making  
18 material omissions of fact and materially false and misleading statements during the Class  
19 Period. Each of the Officer Defendants had actual knowledge that the statements he made were  
20 false and misleading, or acted with reckless disregard for the truth or falsity of those statements,  
21 as demonstrated by the allegations above, and the additional substantial direct and circumstantial  
22 facts and evidence below supporting a strong inference of scienter for each of the Officer  
23 Defendants. Numerous facts and circumstances support a strong inference of scienter on the part  
24 of each of the Officer Defendants, including the facts and circumstances below, among others  
25 detailed in this Complaint:  
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1           •       The extensive regulation which the Company was subject to and the  
2       Officer Defendants' responses to such regulation support a strong inference of scienter.  
3       For example, Defendant Killinger personally received instructions from the OTS  
4       regarding his, the other Officer Defendants', and the Board's responsibilities with regard  
5       to the Company's appraisal practices. As evidenced by, among other things,  
6       communications between WaMu's senior management and federal regulatory authorities  
7       regarding WaMu's responsibilities in its appraisal practices, the Officer Defendants were  
8       involved in setting the Company's appraisal policies and practices. Furthermore, as  
9       discussed above, before and during the Class Period, the federal banking regulatory  
10      authorities issued direct guidance for lending institutions on the appropriate manner in  
11      which to account for subprime and other high-risk lending. Of course, the Officer  
12      Defendants and the Company were also subject to regulation by the SEC concerning,  
13      among other things, their communications with the investing public (including their  
14      financial reporting) and their accounting practices, which are the foundation of the legal  
15      claims made in this Complaint. In connection with those regulations, Defendants  
16      Killinger and Casey each signed sworn certifications that WaMu maintained adequate  
17      internal controls and presented its financial statements in accordance with GAAP at the  
18      end of every quarterly reporting period, when that was not true.

19           •       On every conference call and at every investor conference during the  
20      Class Period, the Officer Defendants spoke and purported to fully and fairly address  
21      questions regarding the Company's home mortgage lending operations. As shown  
22      below, the Officer Defendants carefully prepared for such events with detailed



1 information concerning the Company's true state of affairs and agreed upon what they  
2 would – and would not – reveal to investors about WaMu's business affairs.

3 • As discussed in detail above, WaMu's home mortgage lending operations  
4 were a pillar of the Company and a vital source of its income and planned growth. Not  
5 surprisingly, the Officer Defendants played a significant role in dictating and monitoring  
6 the Company's home lending policies and practices. In fact, the Officer Defendants also  
7 either directed or were warned about and aware of the Company's gross deficiencies in  
8 risk management and the Company's many deficiencies with regard to the quality of the  
9 loans that it underwrote and originated, all of which contributed to the Company's  
10 deteriorated loan quality. In addition to the allegations above, as detailed below, the  
11 Officer Defendants: (1) participated in regular meetings in which the Company's risk  
12 management and loan performance were questioned and criticized; (2) were personally  
13 warned of the Company's deteriorating risk management and accounting standards; and,  
14 (3) received numerous reports which were specifically compiled for review by the Officer  
15 Defendants and the Board reflecting trends in WaMu's business operations, including  
16 loan portfolio performance analyses that identified and addressed the root causes of the  
17 deteriorating performance of the Company's loans. In addition, as discussed below, the  
18 Officer Defendants supervised the Company's underwriting guidelines and were kept  
19 abreast of changes in such guidelines.

20 • In addition, the Company's and the Officer Defendants' improper  
21 accounting for the Allowance support a strong inference of scienter on the part of all the  
22 Officer Defendants. As admitted by the Officer Defendants, who used credit  
23 provisioning for the Allowance as one of WaMu's main "earnings drivers" each quarter,  
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the Allowance was a critical metric for investors. Furthermore, the Officer Defendants' improper accounting for the Allowance materially affected several key line items on the Company's income statement and balance sheet, including net income, assets, and earnings per share. The applicable GAAP provisions and SEC guidelines, as discussed above, fundamental principles that have been in force for years (SFAS 5, the main GAAP provision applicable to the Company's home mortgage lending, became effective in 1978).

- As discussed below, each of the Officer Defendants' extensive experience in the mortgage banking industry also supports a strong inference that each Officer Defendant acted with scienter.

**A. Prior to Start of the Class Period, WaMu Had Tried to Convince the OTS to Exempt the Company from Certain Federal Appraisal Regulations**

483. Through its then-Chief Credit Officer, Mark Hillis, on May 4, 2005, WaMu made an unprecedented and apparently unsuccessful written request to the OTS (the "Appraisal Exemption Request") to decrease the Company's federally-mandated appraisal obligations. Lead Counsel obtained WaMu's Appraisal Examination Request in the course of its investigation. WaMu's Appraisal Exemption Request is further evidence of scienter, as it shows a desire on the part of WaMu and its senior management to avoid appraisals in connection with the Company's home lending.

484. The Appraisal Exemption Request was an attempt by WaMu to set aside certain requirements for what then-Chief Credit Officer Hillis described in WaMu's request as "full appraisals in conjunction with certain federally related real estate related transactions." More specifically, in the Appraisal Exemption Request, WaMu sought to do away with the requirement

of independent appraisals for all of its real estate transactions valued under \$500,000 – or at least double the existing and then-applicable “*de minimis*” appraisal exemption amount.

485. WaMu offered various arguments in support of its stand against appraisals requirements. Among other things, in the Appraisal Exemption Request, WaMu asserted that the requirement for appraisals in connection with federal lending transactions was “obsolete” under many circumstances and that appraisals were inferior to “newer valuation technologies.” WaMu summed up its position in support of an unprecedented repeal of then-and-currently existing appraisal requirements for the Company’s lending business as follows:

Because the \$250,000 transaction value exemption contributes a significant competitive disadvantage to Agency-regulated financial institutions, without a commensurate contribution to the safety and soundness of those institutions, *Washington Mutual Bank strongly recommends that the de minimus* [sic] *exemption [for mandatory appraisals] be raised to at least \$500,000 for loans secured by residential real estate.*

WaMu’s request for appraisal exemptions from the OTS in mid-2005 apparently was denied. As detailed above, instead the Company found other ways to avoid full and fair appraisals by choosing to disregard governing appraisal rules and regulations.

**B. Witnesses Observed the Officer Defendants Discuss and Acknowledge Material, Undisclosed Problems With WaMu’s Lending**

486. Numerous former WaMu employees have confirmed that WaMu senior management, including the Officer Defendants, was acutely aware of the undisclosed problems from which WaMu suffered but which were not disclosed to the investing public, including those WaMu insiders whose accounts are detailed below.

487. As reported by Confidential Witness 79, each of the Officer Defendants was intimately involved in discussing and analyzing WaMu’s loan performance, at a minimum for much of 2006, in preparation for the Company’s 2006 Investor Day held on September 6 and 7,

1 2006. CW 79 was employed at WaMu as a Senior Operations Excellence professional from  
2 October 2002 until December 2007. From July 2006 through December 2006, CW 79 reported  
3 directly to Defendant Cathcart in WaMu's Enterprise Risk Management Group.

4 488. CW 79's primary responsibility during the time that CW 79 worked directly for  
5 Defendant Cathcart was to assist Defendant Cathcart and the other Officer Defendants in  
6 preparing for WaMu's 2006 Investor Day. Indeed, CW 79's time was "100% devoted" to  
7 preparation for the 2006 Investor Day from July until early September 2006. Specifically, during  
8 this period, CW 79 regularly attended meetings among and between Defendants Killinger, Casey,  
9 Rotella, Cathcart, and Schneider, all discussing information that the Officer Defendants knew  
10 about the Company's financial health, risk exposure, and how, and to what degree, to present  
11 information about those topics to investors. One of CW 79's most important responsibilities was  
12 to ensure that all relevant information was available to the Officer Defendants. According to CW  
13 79, there was "a tremendous amount of pressure in preparing for the [2006 Investor Day]  
14 presentation."

15 489. According to CW 79, Defendant Cathcart presided over a monthly Enterprise  
16 Risk (or "Executive Risk") Committee meeting, for which CW 79 served as the secretary. The  
17 attendees of this meeting included Defendants Killinger, Casey, Rotella, Schneider, as well as  
18 each of the business units' President, Chief Financial Officer, and Chief Risk Officer. CW 79  
19 described these meetings as "a forum where all aspects of risk across the bank were discussed,  
20 including credit, market and operational risk." Because the Enterprise Risk Committee was  
21 "formally sanctioned" by WaMu's Board of Directors, CW 79 recalled that its meetings were  
22 typically held in WaMu's main boardroom.  
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1           490. At these monthly meetings, CW 79 explained that the Officer Defendants engaged  
2 in detailed discussions regarding the Company's risk exposure, specifically focused on the  
3 allocation of risk to each WaMu business unit's product lines. CW 79 further explained that, in  
4 preparation for such meetings, the business units would have previously provided to other  
5 executive committees of the Board their financial forecasts or projections, and that during the  
6 meetings of the Executive Risk Committee these financial forecasts were reviewed in detail for  
7 the purpose of allocating risk across the Company. CW 79 cited as examples of this intensive  
8 review the Executive Risk Committee's acknowledgement of particularly high risk in its loan  
9 portfolio relating to specific geographic regions, such as California, and the Executive Risk  
10 Committee's discussion of minimum FICO scores for WaMu's particular loan products.

12           491. Further, more informal meetings among the Officer Defendants – convened  
13 specifically to discuss the 2006 Investor Day preparation – occurred regularly according to CW  
14 79. These meetings occurred, as CW 79 recalled, in several locations, including Defendant  
15 Rotella's office and the WaMu Investor Relations office near Defendant Casey's office. In the  
16 days leading up to the 2006 Investor Day presentation, the Officer Defendants and CW 79  
17 primarily met in Defendant Cathcart's office.

18           492. CW 79 recalled that from the start of CW 79's participation in meetings with the  
19 Officer Defendants in July 2006, the focus for the 2006 Investor Day presentation was on the  
20 Company's risk profile because of heightened investor and media scrutiny on a possible increase  
21 in WaMu loan defaults. CW 79 stated that in preparing for that presentation, the Officer  
22 Defendants were highly focused on deciding what they would and would not reveal to investors.  
23 Defendants Cathcart, Killinger, Rotella, and Casey discussed on numerous occasions the default  
24 rates within the Company's loan portfolios, and in particular WaMu's Option ARM and subprime  
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1 loans, in the meetings that CW 79 attended. According to CW 79, at these meetings, the Officer  
2 Defendants discussed a substantial amount of detailed information regarding levels of  
3 delinquencies concerning many of WaMu's specific loan product types, but the Officer  
4 Defendants elected not to disclose such information to the public. CW 79 specifically stated that  
5 Defendants Cathcart, Killinger, Rotella, and Casey discussed deterioration in the mortgage  
6 industry in general and the problems with WaMu's own portfolios in particular, adding that the  
7 Officer Defendants' objective for their public statements was to mitigate perceived problems  
8 with the Company's loans by highlighting the fact that subprime lending represented a relatively  
9 small percentage of WaMu's overall loan portfolio and overall bank assets.  
10

11 493. As a result of these discussions, according to CW 79, the Officer Defendants  
12 decided to focus their discussion on "the weakening state of the housing market because 'they  
13 saw what was coming.'" In addition, according to CW 79, the Officer Defendants specifically  
14 discussed the need to avoid making any statements that might give rise to liability under the  
15 federal securities laws. After responses to anticipated questions were agreed upon by the Officer  
16 Defendants, the final meetings held in Defendant Cathcart's office, involving Defendants  
17 Killinger, Cathcart, Rotella, and Casey, were all primarily focused on addressing who of the four  
18 would answer different types of questions that might arise from Defendant Cathcart's  
19 presentation.  
20

21 494. CW 79 stated that as a result of the analysis conducted in preparation for Investor  
22 Day 2006, Defendant Killinger reached the conclusion that he wanted to deemphasize the  
23 importance of subprime to WaMu going forward. According to CW 79, Defendant Killinger  
24 specifically discussed his decision to deemphasize subprime as a percentage of the total loan  
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1 portfolio and of the bank's total assets during the Executive Risk Committee meetings attended  
2 by CW 79.

3 495. CW 79 specifically noted that Defendant Schneider would not have been able to  
4 adjust the Company's lending practices as they related to risk without the knowledge and consent  
5 of Defendants Killinger, Cathcart, Casey, and Rotella. In other words, Defendants Killinger,  
6 Cathcart, Casey and Rotella as well as Defendant Schneider were knowledgeable and involved in  
7 establishing and approving the Company's lending policies and guidelines.

8 496. Confidential Witness 80 reported similar face-to-case interactions with the Officer  
9 Defendants, specifically Defendant Casey, in which he was directly informed that the Company's  
10 risk management and accounting standards had dangerously deteriorated, with material effects  
11 on the Company's financial statements. CW 80 was a Senior Vice President for Accounting  
12 Policy at Washington Mutual from June 2006 until November 2007. CW 80 came to WaMu with  
13 twenty years of experience in the lending field, including senior positions at some of WaMu's  
14 direct competitors in the home lending business and after serving as a safety and soundness  
15 examiner at the Federal Reserve Board in Washington D.C. CW 80 is currently employed at a  
16 federal regulatory housing agency.

17 497. CW 80 explained that as SVP and head of accounting policy, he reported to  
18 Washington Mutual's Controller, initially Defendant Woods, and after Woods transferred to  
19 WaMu's Home Loans segment in early 2007, to Defendant Ballenger. CW 80 noted that he  
20 managed a staff of five at WaMu. In this function, CW 80 had significant interaction with  
21 Defendant Cathcart and the Enterprise Risk Group Defendant Cathcart headed, and that he also  
22 interacted regularly with Cliff Rossi, WaMu's Chief Risk Officer, until Rossi left WaMu in  
23 September 2007. In addition, CW 80 stated that he had "significant interaction" with WaMu's  
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1 Chief Financial Officer, Defendant Casey. CW 80 believed that many of WaMu's accounting  
2 policies and practices were improper, including those related to the Company's compliance with  
3 GAAP, and SFAS 5 in particular, and noted that his relationship with Defendant Casey  
4 "progressively worsened due to disputes over accounting policy."

5  
6 498. CW 80 explained that WaMu's risk management function lacked independence,  
7 specifically because Defendant "Casey appeared to exert greater influence over the loan loss  
8 process as opposed to it being independently managed." Moreover, CW 80 believed that  
9 WaMu's "reserving process was diminished as the finance function exerted greater control," and  
10 marginalized those who were qualified to analyze and calculate WaMu's reserves.

11 499. Further, CW 80 shared his opinion that "senior management at Washington  
12 Mutual are contemptuous of their regulator [the OTS]."

13  
14 **C. The Officer Defendants Received Regular Reports Detailing  
Significant and Widespread Problems with WaMu's Loans**

15 500. The Officer Defendants also received various regular and special reports  
16 concerning WaMu's lending practices and loan performance from across the Company.  
17 Confidential Witness 78 served as an Assistant Vice President in the Risk Analytics Group at  
18 WaMu from January 2006 until January 2008. The Risk Analytics group conducted credit risk  
19 analyses on the various portfolios managed by the separate business units at WaMu, including  
20 home loans, commercial loans and credit card portfolios. CW 78's group was involved in  
21 conducting overall analyses of WaMu's portfolios, including analysis of financial results,  
22 delinquency and loss trends, performance drivers and correlation analysis pertaining to economic  
23 trends. In particular, as discussed below, CW 78's group compiled monthly reports analyzing  
24 WaMu's credit risk exposure across the Company, which was then distributed directly to  
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1 Defendants Schneider and Cathcart, and a summary version of the same report, which was  
2 compiled for the Board.

3 501. CW 78 explained that the Risk Analytics Group consisted of approximately  
4 twenty-five professionals and was headed by Tim Bates, Vice President & the head of Credit  
5 Information Strategy and Systems, who reported directly to Hugh Boyle, Chief Risk Officer,  
6 who, in turn, reported to Defendant Cathcart. In general, CW 78 explained that the Risk  
7 Analytics Group gathered data from the Company's Fidelity MSP system, the primary  
8 information system concerning WaMu's portfolio of home loans, and compiled such information  
9 into WaMu's Enterprise Data ("ED") warehouse, a database maintained by the Enterprise Risk  
10 group. The Risk Analytics Group was then responsible for the analysis of the data to identify  
11 any relevant trends affecting the Company as a whole.  
12

13 502. The Risk Analytics Group focused mostly on WaMu's "held for investment"  
14 portfolio, although CW 78 recalled that one notable exception pertained to WaMu's Option ARM  
15 loan securitizations, as CW 78 claimed that the Risk Analytics Group did conduct a significant  
16 amount of analysis on Option ARM loans overall "when it started to become a big deal."  
17

18 503. CW 78 recalled that one of the most important aspects that came up during CW  
19 78's tenure with the Risk Analytics Group concerned the issue of negative amortization as it  
20 pertained to Option ARMs. In addition, CW 78 reported that the Risk Analytics Group identified  
21 noticeable trends in defaults, in particular with Option ARM products and with Alt-A "no doc"  
22 loans in general. "Once real estate valuations started to turn in 2006," CW 78 reported that there  
23 was a "significant focus on defaults as they pertained to specific geographic areas."  
24

25 504. The information noted above and other information that CW 78 was in charge of  
26 collecting was officially compiled and regularly reported to the Officer Defendants. Among  
27

1 other reports, CW 78 stated that her group compiled a monthly report called the “Credit Risk  
2 Review” that was distributed to all of the business groups, including Defendants Schneider and  
3 Cathcart. CW 78 stated that the Credit Risk Review Reports produced by her team focused on,  
4 amongst other things, WaMu’s “riskier products,” including Option ARM loans. These reports  
5 occasionally focused on WaMu’s loan portfolio at the loan level, examining issues like LTV,  
6 FICO scores, “no-doc” versus full loan documentation, and other loan characteristics, adding that  
7 such analysis frequently was performed concerning WaMu’s negative amortization (i.e., Option  
8 ARM) loans.  
9

10 505. In addition, according to CW 78, the Risk Analytics Group also compiled a  
11 “Credit Highlights Report,” an abridged version of the more detailed Credit Risk Review report,  
12 which was compiled specifically for WaMu’s Board of Directors.  
13

14 506. Indeed, this information was widely available to WaMu management across the  
15 Company. CW 15 was a First Vice President in the Capital Markets Group at WaMu Capital  
16 Corp. in New York, New York, from October 2004 until December 2007. CW 15 reported  
17 directly to Doug Potolsky and was in charge of Investor Relations, where CW 15 was  
18 responsible for working with the various investors in the securitized subprime products being  
19 structured and issued by WaMu’s capital markets division. CW 15 was a senior management  
20 level employee with close interaction with Defendant Schneider and other senior executives  
21 responsible for WaMu’s Home Loans segment.  
22

23 507. CW 15 stated that loan defaults “were always well monitored at WaMu” and,  
24 within the Company, “everyone was aware of the negative trends that started to appear in 2005.”  
25 CW 15 stated that WaMu’s management knew about, but never acknowledged, the negative  
26 trends that were being witnessed concerning first payment defaults on WaMu’s loans. Indeed,  
27

1 CW 15 claimed that WaMu's "loan servicing area was doing a good job tracking the defaults that  
2 were taking place."

3 508. Similarly, Confidential Witness 81 served as Staff Accountant in WaMu's Home  
4 Loans Group in Vernon Hills, Illinois from May 2006 until May 2008. CW 81 was involved in  
5 various accounting functions within the group, including in the allocation of mortgage loans  
6 between "held for sale and "held for investment." CW 81's group maintained the accounting for  
7 the entire loan portfolio of the Home Loans division, including the specific allocation of the  
8 portfolio into broader categories (*i.e.*, prime, Alt-A, subprime) as well as more specific categories  
9 such as by loan type.  
10

11 509. Part of CW 81's responsibilities included managing accounting adjustments  
12 pertaining to non-accrual loans. As part of this responsibility, CW 81 was involved in the  
13 generation and analysis of monthly, quarterly and yearly reports for specific loan types, including  
14 (i) Adjustable Rate loans, (ii) Interest Only loans, (iii) Fixed Rate loans and (iv) Hybrid loans.  
15 Partly as a result of this regular reporting, CW 81 recalled that WaMu senior management,  
16 including Defendant Schneider, were "always aware" of what was occurring with respect to the  
17 overall loan portfolio.  
18

19 510. For example, CW 54 who, as described above, performed monthly audits on the  
20 Company's "prime loans," reported that the results of the group's analysis were provided to John  
21 Truong in Seattle, who was then responsible for integrating such information into management  
22 reports that were specifically provided to WaMu's most senior management. CW 54 stated that  
23 the information regarding loan performance certainly reached senior management, including  
24 Defendant Schneider.  
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1           511. The Officer Defendants also closely monitored LBM's loan performance  
2 throughout the Class Period. CW 63 who, as explained above, served as National Underwriting  
3 Manager of LBM, participated in LBM's working level credit policy committee, which  
4 transmitted weekly recommendations on methods to reduce FPDs to the Executive Credit Policy  
5 Committee, which included Defendant Schneider. LBM's lax underwriting had resulted in  
6 increasing defaults and delinquencies, including FPDs and early payment defaults (defined above  
7 as "EPDs"). FPDs were defaults that occurred before the borrower made even one monthly  
8 payment. EPDs were typically loans in which the borrower may have made one or two monthly  
9 payments but then failed to continue making their monthly payments.  
10

11           512. The Executive Credit Policy Committee included Defendant Schneider and  
12 Cheryl Feltgen, Division Executive Chief Credit Risk Officer. The working level committee  
13 included Mark Brown, Senior Vice President and National Underwriting Manager; Susan Sinn,  
14 Wholesale Nonprime Operation Manager; Arlene Hyde, Division Executive Prime and  
15 Nonprime Wholesale Lending; Alex Park, Senior Vice President, Senior Credit Officer -  
16 Subprime; Denise McCrainey, Credit Policy Administrator; and Doug Potolsky, Senior Vice  
17 President, Subprime Capital Markets. The committee also included Jay Weisbrod, LBM  
18 Production Manager, who CW 63 described as extremely vocal in his opposition to any changes  
19 to underwriting guidelines.  
20

21           513. CW 63 explained that the working level credit policy committee's  
22 recommendations were communicated to WaMu's Executive Risk Committee (defined above) by  
23 Alex Park. CW 63 stated that the weekly written recommendations included three sales and  
24 revenue items: (1) impact upon production; (2) estimate of benefits in reducing FPDs; and, (3)  
25 effect upon competition. The weekly document for the Executive Committee's review was  
26  
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1 prepared by Alex Park and Denise McCrainey. Likewise, communications from the executive  
2 level to the working level policy committee were transmitted through McCrainey.

3 514. In addition to monitoring EPDs and FPDs, according to Confidential Witness 82,  
4 WaMu regularly received reports from a group of WaMu employees (rather than LBM  
5 employees) dedicated to reviewing a percentage (typically around 20%) of LBM's loans to  
6 monitor LBM's loan underwriting. CW 82 was an employee of LBM from 2001 until October  
7 2006, serving as an Underwriter and later becoming a Quality Assurance Manager. CW 82  
8 initially reported to Amy Marcussen, Senior Vice President of Operations. After Marcussen left  
9 the company, CW 82 reported to Mamie Reynoso, Vice President of National Quality Assurance  
10 Manager.  
11

12 515. LBM's President, Troy Gotschall, and Marcussen had initially approached CW 82  
13 concerning leading a quality assurance group to monitor LBM's loan underwriting, but the  
14 position ultimately was given to another LBM employee. Nevertheless, CW 82 received reports  
15 from the newly formed group, which he forwarded to LBM's Loan Servicing Center managers.  
16 The reports listed findings on specific loan files, such as "stated income: not reasonable." The  
17 LBM managers receiving the reports through CW 82 had a certain number of days to go through  
18 the loan files in question and respond to the findings in the reports. According to CW 82, WaMu  
19 corporate headquarters received these reports as well. CW 82's quality assurance group had to  
20 respond to the WaMu unit concerning these reports, which in return had to respond to corporate.  
21 If CW 82 did not respond promptly, his boss would call and "give [him] hell."  
22  
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24 516. According to CW 83, who was a Senior Default Foreclosure Loan Specialist with  
25 WaMu's LBM in Chatsworth, California from 2002 to September 2006, WaMu senior  
26 management had complete and constant access to information regarding the rising levels of  
27

1 defaulting LBM loans. According to CW 83, her department received statistics every month that  
2 showed the number of FPDs from the prior month. According to CW 83, the numbers were  
3 consistently decreasing until 2005 when defaults jumped. CW 83 said that at one point the  
4 defaults were at 5-6% but eventually increased to 14%. They seemed to “jump all at once – at  
5 the end of 2004, they were at 6-7% and, although they may have increased slightly, did not go  
6 over 9%.” Starting in 2005, according to CW 83, FPDs just “seemed to go up and up.”

7  
8 517. Beginning in 2005, according to CW 83, WaMu held meetings monthly to discuss  
9 new products and to “go over the numbers from the prior month.” Additionally, according to  
10 CW 83, “Town Hall Meetings” with WaMu corporate executives, including Defendant Killinger,  
11 were held every three to six months. Prior to the start of the Class Period, according to CW 83,  
12 members of corporate management would merely congratulate the department on the  
13 department’s efforts to reduce delinquencies. However, according to CW 83, by late in 2005  
14 these meetings had taken on a new tone: WaMu corporate executives would update WaMu  
15 employees on the state of defaults and reassure them that the Company was “not going  
16 anywhere.” According to CW 83, corporate headquarters also sent emails, reiterating that  
17 despite increased loan defaults, the Company was “not going anywhere.”  
18

19  
20 **D. The Officer Defendants Had Ready Access to  
and Control of the Company’s Internal Reporting**

21 518. Further, in addition to the reports specifically compiled for the Officer  
22 Defendants’ review, detailed information related to the Company’s loan origination, including  
23 standards implemented and exceptions to underwriting guidelines, was automated and readily  
24 available to the Officer Defendants as senior executives of the Company.

25  
26 519. Confidential Witness 84 reported that the Company’s Fidelity MSP system  
27 (discussed above), was the primary resource which tracked all aspects of the loans being

1 processed by WaMu. CW 84 was exceedingly familiar with the Fidelity MSP system relied upon  
2 by WaMu. CW 84 spent almost twenty years at WaMu, most recently serving as a Senior  
3 Accountant in Vernon Hills, Illinois from April 2006 until February 2008. CW 84 explained that  
4 the Fidelity MSP system was set up to conduct queries with respect to any relevant aspects  
5 pertaining to the loans. Specifically, CW 84 explained that the system allowed a user to perform  
6 data mining and generate any number of different reports based on any specific characteristic  
7 pertaining to the product type (*e.g.*, fixed rate, adjustable rate, ARM), specific information  
8 pertaining to the loan and the borrower (*e.g.*, FICO scores, LTV, loan purpose, appraised value),  
9 and information pertaining to the loan status (*e.g.*, defaults, principal outstanding). CW 84  
10 believed that anyone in credit risk management, transaction management, trading and the other  
11 main divisions within Home Loans had access to and could generate reports via the Fidelity  
12 system. CW 84 commented that the information, through Fidelity, was readily available to those  
13 in senior management and accounting, and that the many negative trends that were starting to  
14 take place were well-known.

17 520. Similarly, Confidential Witness 85, who served as a Staff Accountant in Home  
18 Loans Accounting in Vernon Hills, Illinois from April 2006 until February 2008, reported that the  
19 accounting groups of the Company relied upon the Fidelity MSP system. Specifically, CW 85  
20 formed part of the “real estate owned” (“REO”) accounting group, a group of five individuals  
21 that handled the reconciliation of accounts pertaining to mortgage loans that had gone into  
22 foreclosure. Reconciliations were required to reflect the sale of real estate properties that were  
23 owned by the Company as the result the foreclosures.

25 521. CW 85 recalled that the REO group maintained a separate database of information  
26 generated from information feeds from WaMu’s Fidelity MPS system operated within the Home  
27



Loans Group, explaining that any number of specific reports could be generated through the Fidelity system to identify various characteristics of defaulted or foreclosed loans. CW 85 further explained that the database maintained by WaMu's REO group provided specific data pertaining to the foreclosed loans, such as various loan types (i.e., Option ARM, conforming, Alt-A, subprime) and various loan characteristics such as product type and specific details pertaining to the borrower. CW 85 jokingly added that reports were not even necessary to recognize the increase of subprime loans that were being foreclosed and processed through REO during CW 85's tenure.

522. CW 85 explained that on a monthly basis, the REO group prepared extremely detailed "Loan Loss Severity Reports" pertaining to foreclosures and including quantitative analyses of WaMu's foreclosures. According to CW 85, these reports should have been used by WaMu to evaluate and fund WaMu's loss reserve.

523. In addition to the Fidelity MSP system, the Company specifically and separately tracked and monitored all exceptions made to the underwriting guidelines. Confidential Witness 86 served as an underwriting manager for WaMu/LBM in Englewood, CO from May 2007 to February 2008. Previously, CW 86 held the position of underwriter from May 2005 to May 2007. CW 86 worked for LBM until October 2007 when CW 86 "transferred to the prime side [of WaMu]." CW 86 explained that whenever exceptions were made to WaMu's underwriting guidelines, an exception approval sheet would be signed and placed in a file. Additionally, exceptions were documented in two different systems, WaMu's loan origination system ("LOS") and in a database of loans that contained comments on the loan. The same system was in place for both WaMu's subprime and prime underwriting, and, according to CW 86, the Company tracked exceptions through reports generated by this system. Specifically, according to CW 86,



1 the Company's system was used to generate "umpteen reports," including underwriting  
2 exception reports. CW 86 stated that WaMu's management could "pull up reports on anything"  
3 using the system that tracked underwriting exceptions.

4 524. Confidential Witness 69 served as a senior underwriter for WaMu in Livermore,  
5 CA from July 15, 2003 to September 2007. CW 69 also acted as senior underwriting manager at  
6 WaMu from February 2007 until September 2007. According to CW 69, WaMu's corporate  
7 management in Seattle had a system for tracking exceptions to underwriting guidelines that it  
8 reviewed and shared with WaMu's senior management. CW 69 began to see these underwriting  
9 exception reports during the time that CW 69 acted as senior underwriting manager, but had  
10 never seen them prior to that point as WaMu's underwriters were never kept informed about how  
11 the loans they had underwritten were actually performing until directly before CW 69's departure  
12 in late 2007. According to CW 69, during the Class Period WaMu's underwriting exception  
13 reports were very detailed and included the borrower's FICO score, loan amount, the exception  
14 that was being requested, "compensating factors" to supposedly "justify" the exception, and the  
15 percentage of underwriting exceptions per geographic or sales region. According to CW 69, both  
16 WaMu Loan Fulfillment Center ("LFC") managers and WaMu's corporate managers in Seattle  
17 regularly received these exception reports.

18 525. CW 69 was sent to Chicago by WaMu around August 2006 for an internal WaMu  
19 meeting concerning WaMu's increasing loan defaults, which thirty or so other WaMu employees  
20 attended (a corporate risk manager, the top managers of LBM, regional WaMu managers, and a  
21 couple of WaMu loan fulfillment managers). CW 69 was the only underwriter present. Prior to  
22 the August 2006 meeting, even as a senior underwriter CW 69 had not realized that defaults were  
23 a problem at the Company.

1           526. In early to mid 2007, WaMu assigned CW 69 to a specific project to track FPDs at  
2 WaMu. A WaMu LFC manager asked CW 69 to present the data he collected through graphs,  
3 percentages, and pie charts so that it could be presented to WaMu senior management, including  
4 WaMu Vice Presidents, Regional Managers, and the LFC manager. WaMu corporate  
5 management provided the raw data needed for the project. Until this point, CW 69 had not seen  
6 any FPD or EPD reports. These reports showed which types of loans were not performing well.  
7 According to these reports, the biggest problems at CW 69's LFC were higher LTVs and lower  
8 FICO scores, stated income products, and the use of bank statements for calculating income.  
9 CW 69 stated that it was recognized that FPDs and EPDs were the result of poor underwriting  
10 standards: for example, the Company would take twelve months of personal bank statements  
11 and divide the deposits by twelve to arrive at the borrower's income; similarly, for limited  
12 documentation loans, the Company would look at six months worth of bank statements and  
13 divide by six to arrive at the borrower's supposed income.  
14

15           527. Similarly, the Company tracked all information related to loan delinquencies.  
16 Confidential Witness 87 spent over 20 years with WaMu or its predecessor banks, most recently  
17 serving as a Default Specialist in Vernon Hills, Illinois from August 2003 until August 2007.  
18 CW 87 first joined Sears Mortgage in September 1988 until that company was acquired by PNC,  
19 which was itself acquired by WaMu in approximately 2001. As a Default Specialist, CW 87 was  
20 involved in working with borrowers to try to rectify foreclosures and to dispose of the properties  
21 held by WaMu as the result of foreclosures. CW 87 recalled that most of the loans that CW 87's  
22 group worked with as default specialists were loans underwritten by WaMu itself, and were not  
23 loans underwritten by Long Beach Mortgage or any loans purchased through third-party lenders.  
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528. CW 87 recalled receiving reports from WaMu's loan servicing operations in Jacksonville, Florida summarizing the loans that had gone into default, adding that there were clearly increasing levels of defaults and foreclosures beginning in mid-2005. CW 87 said that, among CW 87's colleagues at WaMu, there it was hardly a secret that the levels of loan defaults at WaMu were increasing during the Class Period, stating that at the Company, "everyone knew it."

**E. The Officer Defendants Knew of or Recklessly Disregarded WaMu's Lax Underwriting Guidelines Because Such Guidelines Were Centrally Established and Controlled**

529. Because WaMu's underwriting guidelines directly affected the value and credit quality of WaMu's loans – and therefore were fundamental to WaMu's overall financial condition – WaMu's senior management closely monitored and managed WaMu's prime and subprime home lending underwriting guidelines and operations.

530. As explained below through the reports of numerous former WaMu employees, because WaMu's underwriting guidelines and product offerings were managed at the highest levels of the Company, the Officer Defendants knew, or were reckless in not knowing, that throughout the Class Period, while the Company increased its credit risk exposure by offering exotic, high-risk loans, the Company was also secretly causing its underwriting guidelines and procedures to become exceptionally loose.

531. Confidential Witness 88 was a Vice President and Manager of the Policies & Procedures Administration Group. CW 88 was based in WaMu's Irvine, California corporate offices from 2004 until March 2007. CW 88's group's primary function was maintaining the central repository for Washington Mutual's Conventional Underwriting Guidelines ("CUG") and Product Pricing Guidelines ("PPG"). CW 88's role and responsibilities were Company-wide.

1           532. According to CW 88, WaMu's Credit Policy Review Group, headed by Michelle  
2 Joans, WaMu's Vice President of Credit Policy, set forth the underwriting guidelines in the CUG.  
3 Joans was assisted by approximately seven or eight assistants from around the country, in some  
4 cases working in WaMu's regional loan fulfillment centers. CW 88 described WaMu's process  
5 for making any change to its underwriting guidelines as "regimented" and dependent upon  
6 review and approval from WaMu senior management. Specifically, for any change to be made to  
7 WaMu's CUGs, a "Communication Request" would be submitted to CW 88's group. According  
8 to CW 88, any Communication Requests concerning WaMu's underwriting guidelines required at  
9 least a Senior Vice President's review and signature. For example, CW 88 said a WaMu office in  
10 Texas could submit a request seeking to permit increased LTV limits on WaMu's super jumbo  
11 loans or modifications to the terms of a stated income policy, but such a request would require a  
12 Senior Vice President's signature.  
13

14           533. Once a "Communication Request" regarding WaMu's underwriting guidelines  
15 was received with requisite senior-level sign off, a document was created that consisted of the  
16 original guideline and the proposed guideline reflecting changes requested in a "Communication  
17 Request" or otherwise, marked with "tracked changes," and that document was reviewed by at  
18 least one member of each of the following groups: the Credit Policy Committee, a management  
19 committee that directly reported to the Audit Committee of WaMu's Board, the Legal  
20 Department, and WaMu's Compliance Department. CW 88 explained that proposed  
21 underwriting guideline changes were then discussed in conference calls in which members of  
22 each of these groups would present their positions. According to CW 88, WaMu's underwriting  
23 guidelines could be changed only if the proposed changes to WaMu's underwriting guidelines  
24 received the management-level approval set forth above, but CW 88 also stated that WaMu's  
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1 loan production management frequently “pushed” for changes in WaMu’s underwriting  
2 guidelines during such conference calls and were effective in overriding concerns raised by  
3 WaMu’s legal, compliance or credit departments.

4 534. In addition to these reports, according to Confidential Witness 18, WaMu’s risk  
5 management group would regularly audit the company’s underwriting guidelines and those audit  
6 reports would be submitted to the Company’s Chief Enterprise Risk Officer, Defendant Cathcart.  
7 Those audit reports would review all aspects of WaMu’s underwriting guidelines for risk. It was  
8 CW 18’s understanding that Defendant Cathcart was then responsible for reporting the results of  
9 those internal audits concerning WaMu’s underwriting guidelines to the Officer Defendants and  
10 to WaMu’s Board.

11 535. WaMu senior management also directly monitored, created, and modified  
12 underwriting guidelines at LBM. Confidential Witness 89 was a First Vice President and  
13 Operations Manager with responsibilities for LBM nationwide from 2006-2007. From 2005-  
14 2006, CW 89 was the Regional Operations Manager responsible for the California market.  
15 According to CW 89, any and all changes to the underwriting guidelines of LBM were made by  
16 LBM’s Credit Policy Committee. According to Confidential Witness 63, who served as National  
17 Underwriting Manager of LBM beginning in September 2006 and was a Regional Operations  
18 Manager for LBM prior to that position, the Credit Policy Committee at LBM reported weekly to  
19 the WaMu Executive Credit Policy Committee, which included Defendant Schneider.

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23 **F. The Officer Defendants’ Extensive Industry  
24 Experience Supports a Strong Inference of Scienter**

25 536. The Officer Defendants possessed extensive industry, accounting and/or finance  
26 experience and education sufficient to understand and alert them to the serious consequences to  
27 the Class of the fraud they were directing at WaMu:

- 1 • Defendant Killinger joined WaMu in 1982 and held numerous senior positions at WaMu,  
2 including executive vice president; senior vice president for financial management,  
3 research, investor relations and corporate marketing; and, served as a member of a three-  
4 person Office of the President. Defendant Killinger also holds bachelor's and Master of  
5 Business Administration degrees.
- 6 • Among other jobs, Defendant Casey, from 1997 until he joined WaMu, served as Vice  
7 President of the General Electric Company and Senior Vice President and Chief Financial  
8 Officer of GE Insurance. Prior to joining GE, Defendant Casey worked for Coopers &  
9 Lybrand from 1984 until 1990 as an audit supervisor focusing on the financial services  
10 industry. Defendant Casey holds a bachelor's degree in accounting.
- 11 • Prior to joining WaMu, among other positions, Defendant Rotella served as a member of  
12 the JP Morgan Chase executive committee, Chief Executive Officer of Chase Home  
13 Finance, and as Executive Vice President of JP Morgan Chase. In these positions,  
14 Defendant Rotella was responsible for JP Morgan Chase's residential lending and he also  
15 oversaw related capital markets, portfolio management, marketing, credit, human  
16 resources, finance and legal activities. Defendant Rotella holds a bachelor's degree in  
17 economics and a Master's of Business Administration in finance.
- 18 • Defendant Cathcart was Executive Vice President of Retail Risk Management for  
19 Canadian Imperial Bank of Commerce from 2002 to 2005, and prior to that served in a  
20 variety of senior risk management positions at Bank One.
- 21 • Defendant Schneider, among other jobs in the lending and financial services industries,  
22 served as President and Chief Operating Officer of CitiMortgage, Inc. from 2001 to 2005,  
23 and was Executive Vice President of Retail Banking for Old Kent Financial Corporation  
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1 from 1997 to 2001. Defendant Schneider holds a bachelor's degree in accounting and a  
2 Master's of Business Administration degree and he is also a licensed CPA.

3 **G. The Officer Defendants Were Motivated by Their**  
4 **Performance-Driven Compensation to Overstate the**  
5 **Company's True Financial Condition**

6 537. Defendants Killinger, Casey, Rotella, Cathcart and Schneider also had both  
7 motive and opportunity to perpetrate fraud. Each of the Officer Defendants had a tremendous  
8 stake in driving WaMu to meet certain financial benchmarks during the Class Period, since each  
9 of these Officer Defendants' annual bonuses was dependant on WaMu meeting certain goals and  
10 objectives. According to WaMu's proxy statements from the years 2005 through 2007, the  
11 Officer Defendants' incentive-based pay was based largely on – 75%, 85% and 90% for fiscal  
12 years 2005, 2006 and 2007, respectively – achieving certain financial performance measures,  
13 including, among others: (a) increasing WaMu's earnings per share; (b) decreasing WaMu's non-  
14 interest expense; and (c) increasing WaMu's non-interest income (for 2007 only). The chart  
15 below details the annual bonuses these Defendants gained – over and above their salaries – by  
16 maximizing these metrics, including the bonuses they received after their fraudulent scheme  
17 began to be revealed in 2007.  
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**Chart 11: Officer Defendants and Annual Bonuses**

<b>Officer Defendant</b>	<b>2005 Bonus</b>	<b>2006 Bonus</b>	<b>2007 Bonus</b>
<b>Killinger</b>	\$3,555,000	\$4,074,000	\$1,189,000 <sup>6</sup>
<b>Rotella</b>	\$2,896,057	\$3,142,800	\$912,800
<b>Casey</b>	\$1,303,548	\$1,356,060	\$391,200
<b>Cathcart</b>	N/A	Not Disclosed	\$153,220
<b>Schneider</b>	\$492,914	Not Disclosed	Not Disclosed

538. The Officer Defendants attempted to continue this pattern of windfalls even after their scheme was exposed and the Company's true financial situation was revealed. On March 3, 2008, the Company announced that the 2008 bonus targets and performance measures for the Company's executives would exclude loan loss provisions and foreclosure expenses from the calculation of executive bonuses. Specifically, the performance measures included, among other metrics, the "Company's 2008 net operating profit, weighted at 30%, calculated as operating profit before income taxes and excluding the effects of (i) loan loss provisions other than related to our credit card business; and (ii) expenses related to foreclosed real estate assets. This plan was ultimately abandoned due to intense shareholder criticism and objection.

539. Moreover, partly as a result of the bonus awards received during the Class Period, Defendants Killinger, Rotella, Casey, Cathcart, and Schneider reaped significant overall compensation for each of the years during the Class Period. These Defendants received total compensation as follows:

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<sup>6</sup> Per the Company's 2007 Compensation Proxy, Officer Defendant Killinger did not accept the 2007 Cash Bonus of \$1,189,900 he was entitled to under the 2007 EPS, 2007 NIE and 2007 NII performance measures set in the 2007 Compensation 8-K. However, the 2007 Compensation Proxy also disclosed that the *forgone bonus would still be counted toward Defendant Killinger's post-retirement benefits*. Therefore, because Officer Defendant Killinger received a benefit from the Cash Bonus, it is included in determining the percentages of direct compensation tied to financial performance.



**Chart 12: Officer Defendants and Annual Compensation**

<b>Officer Defendant</b>	<b>2005 Compensation</b>	<b>2006 Compensation</b>	<b>2007 Compensation</b>
<b>Killinger</b>	\$13,719,571	\$14,245,859	\$5,250,770
<b>Casey</b>	\$4,368,422	\$4,565,581	\$2,440,646
<b>Rotella</b>	\$17,419,664	\$8,452,994	\$3,926,531
<b>Cathcart</b>	N/A	Not Disclosed	\$1,961,984
<b>Schneider</b>	\$2,340,607	Not Disclosed	Not Disclosed

**H. Insider Stock Sales by Defendant Killinger During the Class Period Were Highly Unusual and Suspicious**

540. The Class Period sales of WaMu stock by Defendant Killinger were highly unusual, and therefore suspicious, as measured by (1) the amount and percentage of shares sold, (2) comparison with Defendant Killinger's own prior trading history and that of other insiders, and (3) the timing of the sales. Such sales therefore provide strong evidence of scienter.

541. To evaluate Defendant Killinger's selling activity, experts retained by Lead Counsel used publicly available trading data reported on Defendant Killinger's behalf to the SEC on the SEC's Form 4. Lead Counsel, through experts, analyzed the trading by insiders that occurred during the Class Period and during the equal-length period immediately preceding the Class Period, beginning January 13, 2003 and ending October 17, 2005 (the "Control Period"). As demonstrated below, Defendant Killinger's Class Period sales were extremely large and highly unusual.

**1. Defendant Killinger's Stock Sales Increased Tremendously During the Class Period**

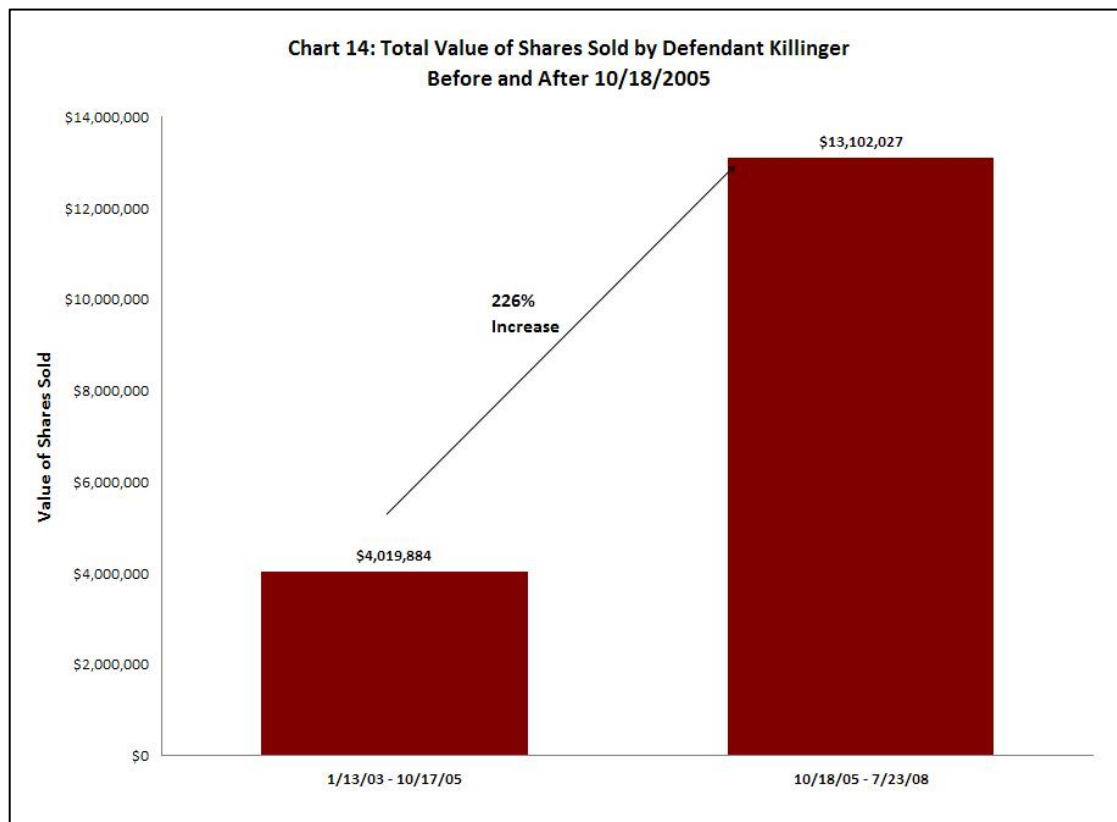
542. As reflected in the following table, the amount of shares Defendant Killinger sold during the Class Period were extraordinarily large, and at a relatively high price:

**Chart 13: Defendant Killinger's Class Period Sales of WaMu Stock**

<b>Class Period Sales (Shares)</b>	<b>Class Period Sales (Dollars)</b>	<b>Average Share Price</b>
301,688	\$13,102,027	\$43.43

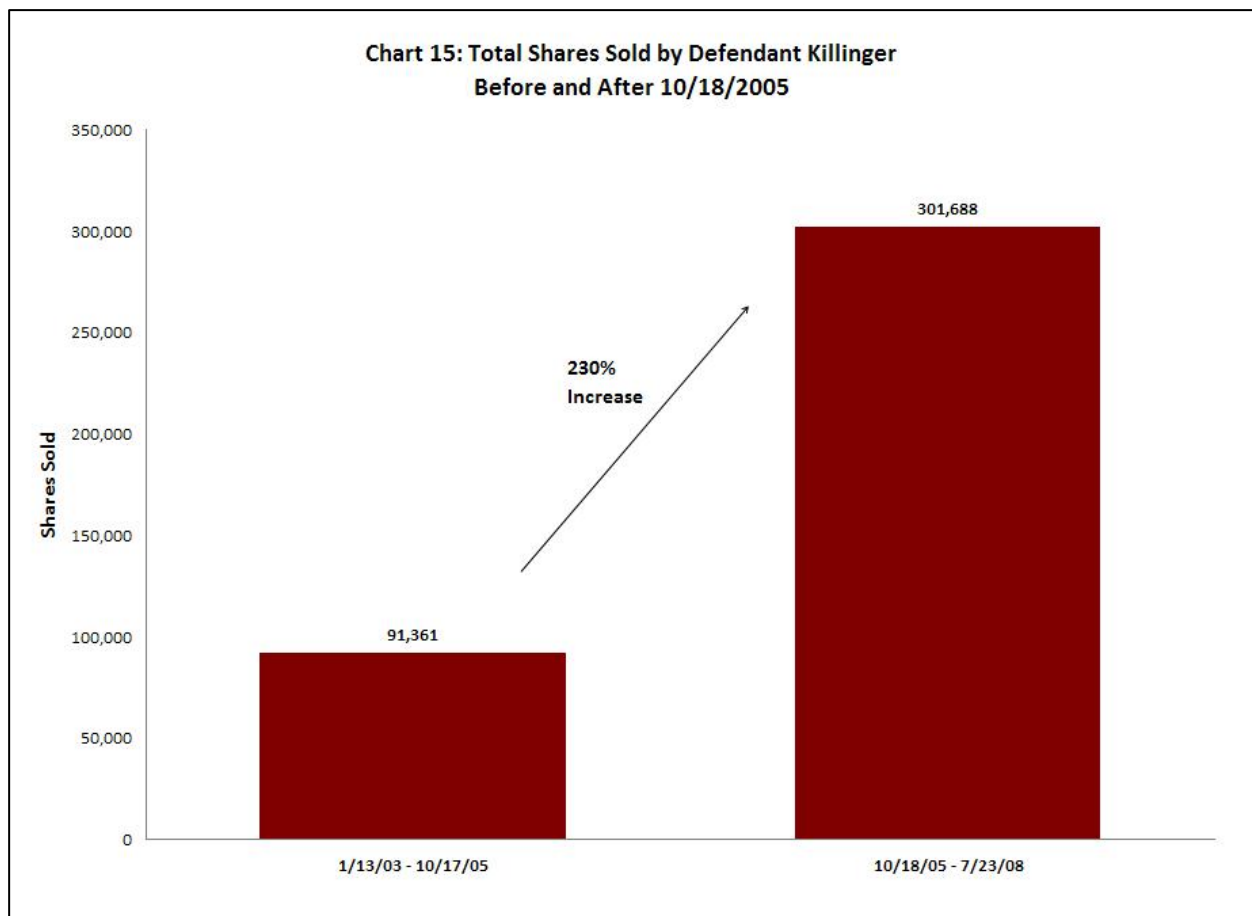
543. In addition to being massive in absolute terms, sales by Defendant Killinger during the Class Period were extraordinary when compared to his own prior selling activity, and when compared to the selling activity of other, less well-placed and knowledgeable insiders.

544. A comparison of the sales by Defendant Killinger during the Control and Class period is set forth in the below chart:



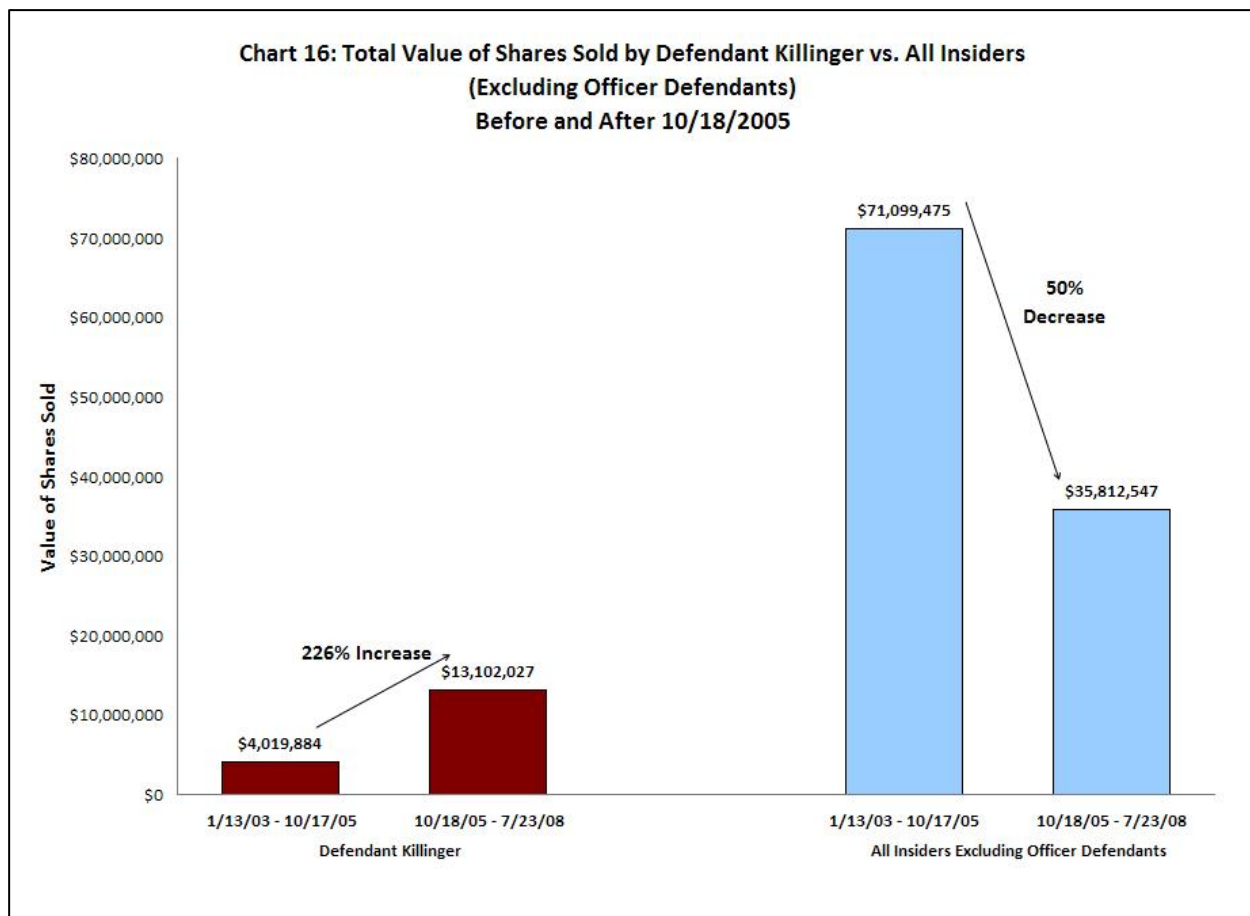
As set forth in Chart 14, Defendant Killinger's sales increased more than 226% during the Class Period, from approximately \$4 million prior to the Control Period to more than \$13.1 million during the Class Period.

545. The contrast between Defendant Killinger's sales prior to the Class Period (referred to as the "Control Period," January 13, 2003 through October 17, 2005) and the Class Period is equally striking when measured in shares sold, rather than dollars, as set forth in the following chart:



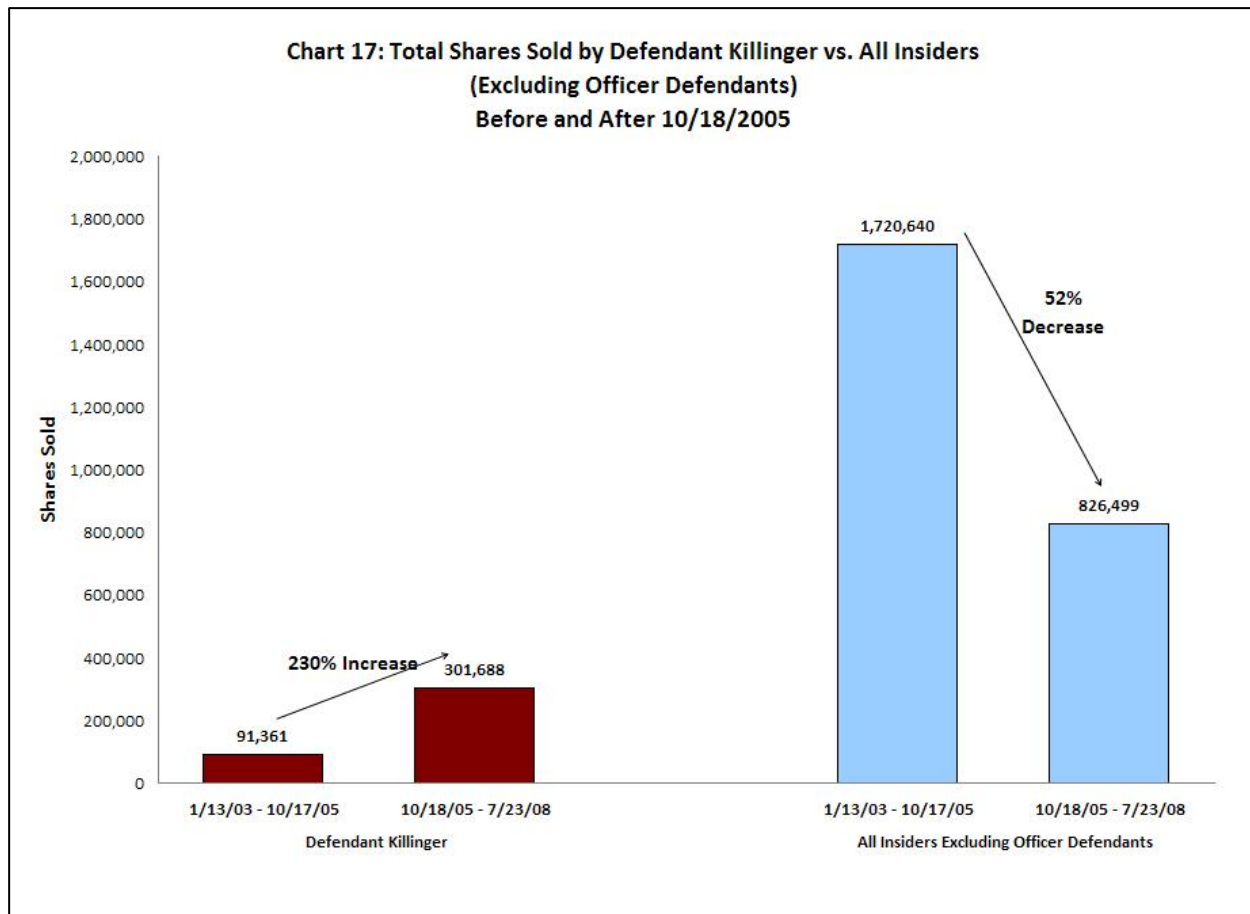
By this measure, Defendant Killinger increased his sales by 230% in the Class Period, compared to the Control Period before the Class Period.

546. The increase in Defendant Killinger's selling is even more striking when compared to the sales pattern of other WaMu employees, who lacked Defendant Killinger's knowledge of the Company's true finances and operational condition. As a group, WaMu employees that are not named as defendants under Lead Plaintiff's claim for violations of Section 10(b) of the Exchange Act (i.e., securities fraud) sold shares worth \$35.8 million during the Class Period, a decrease of 50% compared with the Control Period. By contrast, as noted above, Defendant Killinger increased his selling more than 225%, to more than \$13.1 million:



547. The contrast between Defendant Killinger and less senior WaMu insiders not alleged to have actively played a role in the fraud at WaMu is equally acute when calculated on

the basis of the number of shares sold. While Defendant Killinger's sales increased 230%, non-Defendants' sales, collectively, actually *decreased by half*.



## 2. Defendant Killinger's 10b5-1 Trading Plan and Trading Patterns Further Demonstrate the Suspicious Nature of His Selling

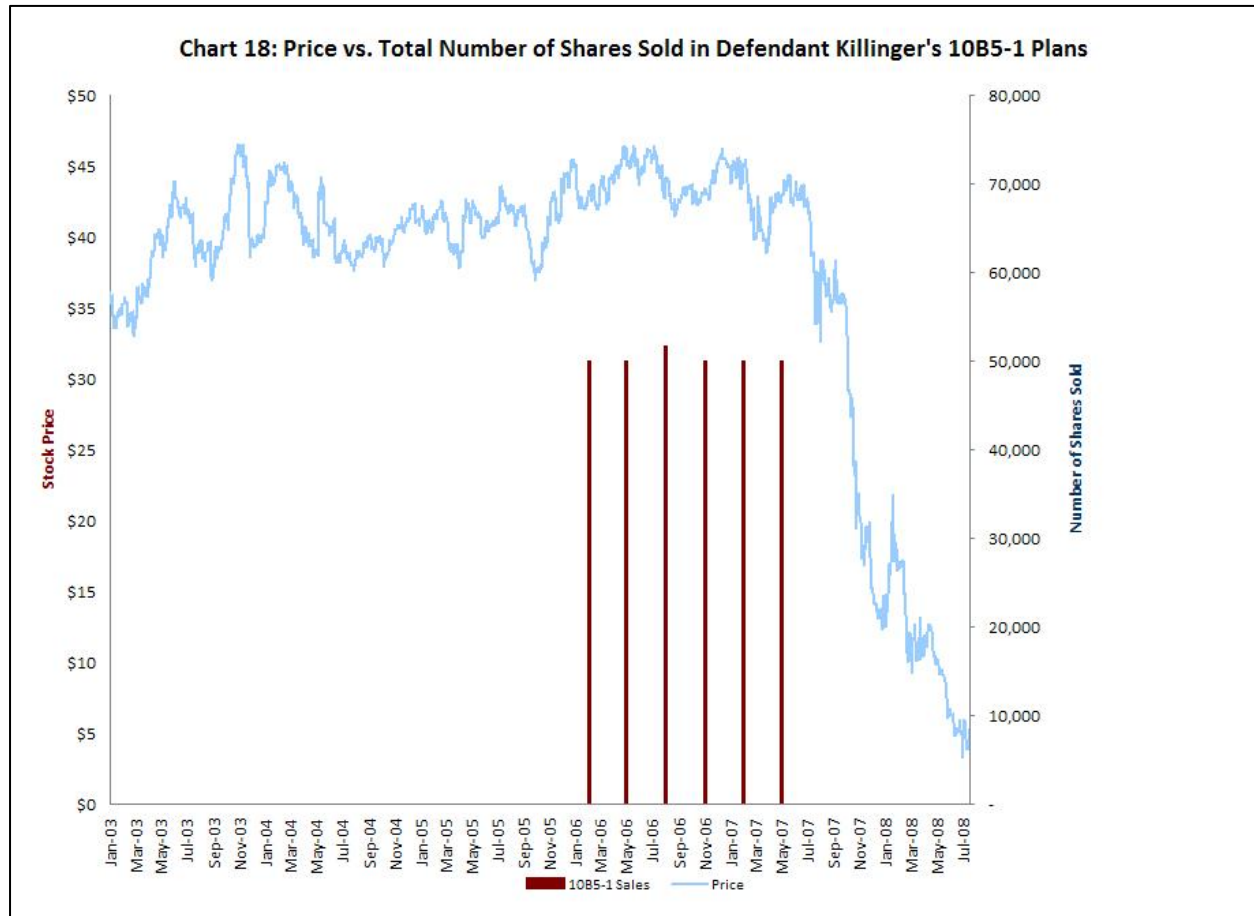
548. In 2000, the SEC adopted Rule 10b5-1, 17 C.F.R. § 240.10b5-1, which provides that a person will be deemed to have traded "on the basis of" material, nonpublic information if the person engaging in the transaction was "aware of" that information at the time of the trade. Previously, courts had split on whether simple possession of material, nonpublic information at the time of the trade was a sufficient basis for imposing liability, and some courts had held that

1 liability attached to a trade only if the insider “used” inside information in making the trade. *See*  
2 Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, at 51,727 (Aug. 24, 2000).

3 549. To provide a safe harbor under the “aware of” standard, the SEC created an  
4 affirmative defense to insider trading claims for trades made pursuant to a binding agreement or  
5 plan (“10b5-1 Trading Plans”). *See id.* at 51,727-28. Pursuant to SEC Rule 10b5-1(c), a 10b5-1  
6 Plan is a defense to insider trading liability only if it is entered into by an insider “before  
7 becoming aware” of inside information, and was established “in good faith and not as part of a  
8 plan or scheme to evade the prohibitions” against insider trading.

9  
10 550. Defendant Killinger instituted a 10b5-1 Trading Plan on or around February 6,  
11 2006, approximately four months after the start of the Class Period and after, as alleged in this  
12 Complaint, Defendant Killinger was aware of inside information concerning WaMu’s true,  
13 deteriorating financial condition. Defendant Killinger’s first 10b5-1 Trading Plan allowed him to  
14 sell up to 150,000 WaMu shares. Defendant Killinger executed 3 sales of approximately 50,000  
15 shares each in three separate installments pursuant to his first 10b5-1 Trading Plan. Once  
16 Defendant Killinger completed those sales, he initiated a second 10b5-1 Trading Plan in October  
17 2006 in order to double his insider sales, with another three installments of sales of around  
18 50,000 WaMu shares each, for a grand total of over 300,000 shares sold.

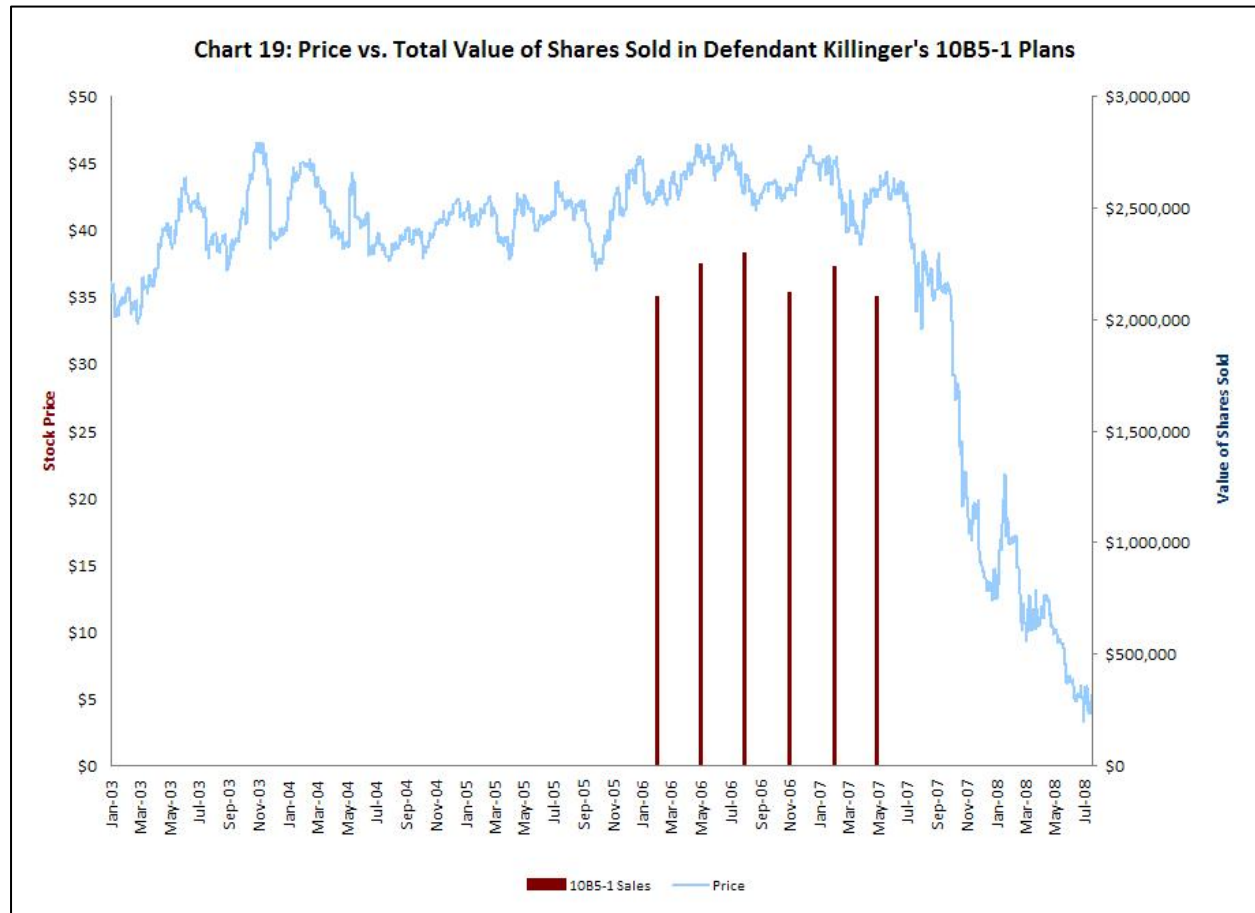
19  
20 551. The pattern of Defendant Killinger’s suspicious sales is reflected in the chart  
21 below, which also shows WaMu’s common stock price at the time of Defendant Killinger’s sales:  
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23  
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As illustrated by Chart 18, above, Defendant Killinger suspiciously instituted his 10b5-1 Plans around four months after the start of the Class Period and concluded his 10b5b-1 plans in May 2007, shortly before WaMu's stock price began to plummet when the market began to learn of WaMu's true financial condition starting with WaMu's surprise October 17, 2007 announcement that it would be increasing its reserves. Moreover, Defendant Killinger concluded his stock sales before the NYAG Complaint was filed concerning WaMu's unlawful appraisal practices, but suspiciously during the course of the New York Attorney General's investigation into such improper appraisal practices. Indeed, as set forth above, the NYAG Complaint was filed after the Attorney General's office conduct a nine-month investigation. Accordingly, Defendant Killinger was able to unload his WaMu shares at prices that reflected artificial inflation in

WaMu's stock price due to the fraud that WaMu, Defendant Killinger and the other Officer Defendants orchestrated.

552. Defendant Killinger's pattern of sales is just as unusual when comparing the total value of the shares sold:



### 3. The Increase in Stock Sales at the Same Time as WaMu Initiated Major Stock Buybacks Further Demonstrates Their Suspicious Nature

553. Defendant Killinger's high rate of sales during the Class Period is particularly suspicious because it occurred while WaMu was repurchasing significant amounts of its own shares from the market.



1           554. WaMu's first stock buyback program – for up to \$100 million in WaMu stock –  
2 was adopted on October 18, 2005 (the “2005 Buyback Program”). Defendant Killinger  
3 commented on the 2005 Stock Buyback Program on November 15, 2005, at the WaMu New  
4 York Investor Day, saying, “Now today we are especially interested in share repurchase because  
5 we believe the current stock price does not reflect our long term growth opportunities as well as  
6 the growing value of our unique franchise.” However, notwithstanding Defendant Killinger's  
7 pronouncements regarding the Company's long-term growth opportunities, he went on to  
8 institute the first of his 10b5-1 trading plans on February 7, 2006. Over the next few months,  
9 Defendant Killinger went on to sell his WaMu stock in 50,000 share increments during the 2005  
10 Stock Buyback Program, for total profits of \$6,648,247.

11  
12           555. On July 18, 2006, WaMu announced a second buyback of approximately \$150  
13 million in stock. Defendant Killinger discussed this repurchase plan on the Company's second  
14 quarter 2006 earnings call on July 19, 2006, commenting that the Board “approved a new 150  
15 million share stock repurchase plan. We expect to actively utilize that authority as we find our  
16 stock to be a very attractive investment compared to other asset investment alternatives.” Again  
17 notwithstanding his comments regarding the health of the Company's stock, thereafter Defendant  
18 Killinger renewed his 10b5-1 trading plan for an additional 150,000 shares of WaMu stock.  
19 Defendant Killinger's sales under his 10b5-1 Trading Plans continued during this period for an  
20 additional 150,000 shares at a profit of \$6,453,780.

21  
22           556. Thus, at exactly the time Defendant Killinger was sharply increasing his personal  
23 sales of WaMu stock, he was causing the Company to engage in repurchases of its own stock.  
24 The immediate consequence of the buybacks was to support the Company's share price, and the  
25 ultimate effect was to secure large profits on Defendant Killinger's own sales during the Class  
26  
27

1 Period, while the Company, and through it, the Class, suffered massive losses on the shares  
2 WaMu repurchased.

3 **VIII. DEFENDANTS' MATERIALLY MISLEADING OMISSIONS AND**  
4 **FALSE STATEMENTS**

5 **A. False & Misleading Statements**  
6 **Concerning Third Quarter 2005 Results**

7 557. On October 19, 2005, the first day of the Class Period, WaMu issued a press  
8 release announcing its financial results for the quarter ending September 30, 2005. In this press  
9 release, WaMu reported that, for the third quarter 2005, the Company had net income of \$821  
10 million, or \$0.92 per diluted share, and total assets of \$333.6 billion. In commenting on the  
11 Company's "solid" performance, Defendant Killinger stated: "Our solid third quarter earnings  
12 reflected excellent retail banking household growth driven by our long track record of industry  
13 leading customer service, as well as our ability to adjust to a challenging interest rate  
14 environment . . . . *The results also highlight our continued focus on balanced growth,*  
15 *earnings diversity and risk management.*"

16 558. In this press release, the Company also reported that its provision for loan and  
17 lease losses was \$52 million, compared to \$56 million in the fourth quarter 2005, bringing the  
18 Company's total Allowance for Loan and Lease Losses to \$1.26 billion. The Company noted  
19 that the provision consisted of: (i) \$37 million that was a one-time special provision related to  
20 Hurricane Katrina, and (ii) \$15 million related to the Company's ongoing risk management  
21 practices.

22 559. On that same day, the Company held an earnings call with investors to discuss the  
23 third quarter 2005 results. On the call, Defendant Killinger announced that the Board of  
24 Directors had elected to increase the cash dividend by \$0.01 to \$0.49 per share. In addition,  
25 Defendant Killinger discussed the Company's Home Loans Group, stating that it had "performed

1 well, despite a much more competitive pricing environment. Loan volume was a solid \$48  
2 billion, up 7% from the second quarter.” “Looking ahead,” Defendant Killinger declared, “we  
3 believe we can effectively manage our credit quality by *continuing to be disciplined and*  
4 *vigilant in our underwriting standards, our portfolio management, and our reserving*  
5 *methodology.*” Indeed, Defendants touted the credit quality of the Company’s loan portfolio and  
6 the Company’s risk management efforts repeatedly. On that same earnings call, Defendant  
7 Casey claimed, “Our credit performance continues [to be] very good . . . *We continue to*  
8 *proactively manage our credit risk, and are taking steps now to reduce potential future*  
9 *exposure.*”  
10

11 560. Further, on the third quarter 2005 earning call Defendant Casey reassured  
12 investors that the overwhelming majority of the Company’s Option ARM portfolio had LTV  
13 ratios below 80%. He noted that, despite an increase in negative amortization in the Company’s  
14 Option ARM portfolio, “only about 8% of current portfolio of option ARMs had [LTV ratios] at  
15 origination in excess of 80%. Less than 2% of the portfolio had LTV [ratios] at origination  
16 above 90%.”  
17

18 561. On or about November 7, 2005, the Company filed with the SEC a Form 10-Q for  
19 the period ending September 30, 2005, which was signed by Defendant Casey (the “Third  
20 Quarter 2005 Form 10-Q”). The Third Quarter 2005 10-Q repeated the financial results set forth  
21 in the Company’s October 19, 2005 press release and earnings conference call. The Third  
22 Quarter 2005 Form 10-Q also stated that “[t]he Company’s financial reporting and accounting  
23 policies conform to accounting principles generally accepted in the United States of America  
24 (‘GAAP’).”  
25  
26  
27

562. The Third Quarter 2005 Form 10-Q included signed certifications by Defendants Killinger and Casey stating, in pertinent part:

- (1) I have reviewed this quarterly report on Form 10-Q of Washington Mutual, Inc.;
- (2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

563. Additionally, in signing these attestations, Defendants Killinger and Casey certified that they had designed, established, and maintained an effective system of internal controls and procedures over the Company's financial reporting that is "effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934."

564. The Third Quarter 2005 Form 10-Q also contained a description of the Company's risk management efforts as follows:

Enterprise Risk Management works with the lines of business to establish ***appropriate policies, standards and limits designed to maintain risk exposures within the Company's risk tolerance.*** Significant risk management policies approved by the relevant management committees are also reviewed and approved by the Board, Audit, and Finance Committees. Enterprise Risk Management also provides ***objective oversight of risk elements inherent in the Company's business activities and practices*** and oversees compliance with laws and regulations, and reports periodically to the Board of Directors.

565. Defendant Killinger's statements in WaMu's 2005 third quarter earnings release and earnings call regarding the quality of WaMu's underwriting standards, including that the Company was "disciplined and vigilant in [its] underwriting standards," were false and

misleading when made. The Company's statements during the third quarter 2005 press release and earnings call and the Third Quarter Form 10-Q regarding the quality of the Company's credit risk management were also false and misleading when made. The Company omitted from the Third Quarter Form 10-Q the material facts that, as set forth in detail above and as reported by numerous Confidential Witnesses, starting in 2005 and continuing throughout the Class Period, the Officer Defendants caused the Company's credit risk management to deteriorate significantly. The Company also omitted from the Third Quarter Form 10-Q the material facts that, along with the aforementioned deterioration in the Company's risk management, WaMu's loan underwriting standards were dangerously relaxed, and WaMu encouraged its employees to make exceptions to the Company's already lenient underwriting guidelines in order to maximize WaMu's loan volume. The Company's undisclosed, lenient underwriting standards had caused the Company to increase materially its loss exposure by originating loans to less qualified borrowers. Further, as detailed above, the Company's loan-volume-focused incentive structures and the culture created by WaMu's senior management, including the Officer Defendants, had caused WaMu, through its personnel, to sell and approve riskier loans without adequately considering the quality of such loans. In addition, as discussed above, the Company failed to disclose that WaMu secretly had pressured its appraisers to inflate the stated value of the homes underlying these loans, thus manipulating the LTV ratios for WaMu's mortgages and exposing the Company to much greater credit risk than was disclosed to investors.

566. Finally, Defendants Killinger's and Casey's certifications in the Third Quarter 2005 Form 10-Q that the Company's financial results were reported in accordance with GAAP and that the Company maintained adequate internal controls were each materially false and misleading when made. As explained above, during the Class Period, the Company's internal

controls over financial reporting suffered from significant deficiencies and material weaknesses because of, among other things, the Company's failure to address material deficiencies in its risk management, loss modeling methodology and other failures of internal controls (including those identified above in connection with Plaintiffs' allegations regarding WaMu's CRO Report). Moreover, rather than appropriately accounting for the Company's lax underwriting standards and inflated appraisals (thus signaling to the market how dangerously exposed the Company was to credit risk) or disclosing the known failures in its internal controls and Allowance methodology, the Officer Defendants caused the Company to under-provision its Allowance for Loan Losses throughout the Class Period, causing the Company's net income, earnings per share, and total assets to be overstated.

**B. Defendants' False & Misleading  
Statements at WaMu's 2005 New York Investor Day**

567. On November 15, 2005, the Company hosted an Investor Day Conference in New York. At that conference, Defendant Killinger highlighted the Company's underwriting and reserving methodologies, stating that these practices minimized the Company's credit exposure and would protect investors from the inevitable downturn in the market:

*On credit risk. We have excellent processes, policies, underwritings, standards and reserving methodologies in place and they have served us very well for quite some time. . . . Now you have heard my conservative voice on the housing market for several quarters now. We were concerned that housing prices appeared over extended in many markets around the country and we felt that the housing market was likely to cool. To prepare for this possibility we elected to selectively reduce credit risk this year. . . .*

Now these actions may have limited near term profitability but they help protect us from a softer housing market if that were to occur.

At the same conference, Defendant Killinger again emphasized the Company's ongoing risk management efforts, stating "*I think proper credit management does not wait until there is a major problem and then say what do I do, running around with my – like my head's cut off. . .*

1 . . . *And so I think good credit management is all about what do you before the problem is*  
2 *there[.]*” Similarly, at the Investor Day Conference, Defendant Schneider announced: “In  
3 addition, *we’ve maintained effective risk management processes*. This is clearly a top priority  
4 for us. We’ve invested a significant amount in terms of talent and technology in building risk  
5 management[.]”

6  
7 568. Defendant Schneider also represented that the Company had tightened its  
8 underwriting guidelines for its Option ARM product, “a mainstay of Washington Mutual for a  
9 number of years[.]” Specifically, Defendant Schneider said, “[w]e’ve done a few things to  
10 improve our margins [for Option ARM loans] . . . . Those combined with some tightening of  
11 underwriting guidelines primarily around the investor property will ensure that we can generate  
12 higher margins and receive the required returns on the product.”

13  
14 569. The Company also emphasized the quality of its subprime underwriting practices  
15 at the Investor Day Conference. Specifically, Craig Chapman, President of the Commercial  
16 Group, the division of the Company that housed Long Beach Mortgage prior to 2006, addressed  
17 WaMu’s “prudent” growth in the subprime area and “disciplined” subprime operations, stating:  
18 “*we allow no rate exceptions in the process*. Our pricing is controlled centrally. It’s distributed  
19 through the network. There is process in place and triggers so that no loans can – there are no  
20 rate exceptions, I mean, on loans.” Chapman also stressed that, with respect to the Company’s  
21 adjustable-rate mortgages, “*we underwrite these loans at a fully indexed rate*. Even our  
22 [interest-only] loans are underwritten on 30-year amortizing and not at any introductory rates or  
23 just interest only rates.”

24  
25 570. Defendants Killinger’s and Schneider’s statements at the 2005 Investor Day  
26 Conference regarding the quality of WaMu’s underwriting standards and the quality of the  
27



1 Company's credit risk management were also false and misleading when made. As set forth  
2 above and as attested to by numerous Confidential Witnesses, starting in 2005 and continuing  
3 throughout the Class Period, the Officer Defendants caused the Company's credit risk  
4 management to deteriorate significantly. Moreover, instead of proactive risk management that  
5 was a "top priority," as Defendant Killinger claimed that the Company maintained, in fact  
6 WaMu's risk management group had been marginalized and lacked authority. Indeed, as  
7 explained above, even when the Company's risk management identified serious problems at the  
8 Company relating directly to the Company's financial health, such warnings were ignored by  
9 WaMu and the Officer Defendants.

11         571. The Company also omitted the material facts that, along with the aforementioned  
12 deterioration in the Company's risk management, WaMu's loan underwriting standards were  
13 dangerously relaxed, and WaMu encouraged its employees to make exceptions to the Company's  
14 already lenient underwriting policies in order to maximize WaMu's loan volume. The  
15 Company's undisclosed, lenient underwriting policies had caused the Company to increase  
16 materially its loss exposure by originating loans to less qualified borrowers. Further, as detailed  
17 above, the Company's loan-volume-focused incentive structures and the culture created by  
18 WaMu's senior management, including the Officer Defendants, had caused WaMu, through its  
19 personnel, to sell and approve riskier loans without adequately considering the quality of such  
20 loans. In addition, as discussed above, the Company failed to disclose that WaMu had secretly  
21 pressured its appraisers to inflate the stated value of the homes underlying these loans, thus  
22 manipulating the LTV ratios for WaMu's mortgages and exposing the Company to much greater  
23 credit risk than was disclosed to investors.



572. Furthermore, contrary to Chapman's statements to the investing public, WaMu's growth in subprime lending was not "prudent"; instead, it was driven by highly aggressive lending practices, through which WaMu issued high-risk mortgages to unqualified borrowers with poor credit. Directly contrary to Defendants' statements, the Company had not maintained "proper" or "effective" credit risk management, and the Company had loosened its underwriting guidelines in its attempt to spur growth. Further, Chapman's explicit comments regarding the purported fact that WaMu did not allow rate exceptions and underwrote its adjustable rate mortgages to the fully-indexed rate were false and misleading when made. In fact, as explained above, the Company had encouraged many so-called "exceptions" to its already loose underwriting guidelines. For example, as discussed by CW 66, above, even salespeople were allowed to grant rate exceptions at WaMu's LBM. Moreover, the Company had, in fact, been underwriting its adjustable-rate mortgages (including its Option ARM loans) to the "teaser" rate, rather than the fully-indexed rate.

573. Analysts responded favorably to the Company's third quarter 2005 earnings announcement. In a D.A. Davidson & Co. report dated October 20, 2005, analyst Jim Bradshaw remarked that although the Company faced margin pressure, it "maintain[ed] decent year-over-year growth by controlling costs and growing the balance sheet while enjoying strong credit quality." Bradshaw also commented that "credit quality remains very good."

**C. False & Misleading Statements Concerning  
Fourth Quarter & Year-End 2005 Results**

574. On January 18, 2006, WaMu issued a press release announcing its financial results for the quarter and year-ended December 31, 2005. In this press release, WaMu reported that, for the fourth quarter 2005, the Company's reported net income was \$865 million, or \$0.85 per diluted share, an increase of 12 percent on a per share basis from the fourth quarter of 2004

1 and, for the full year 2005, the Company's reported net income was \$3.43 billion, or \$3.73 per  
2 diluted share, an increase of 14% from 2004. In the press release, Defendant Killinger  
3 commented on the Company's favorable financial results, stating: "Despite the challenging  
4 environment, especially in the home loans business, we delivered solid performance . . . . Our  
5 strategies are sound and we continue to execute on our growth and productivity initiatives. In  
6 addition, *our risk management efforts are on track*[.]"

7  
8 575. On that same day, the Company held an earnings call with investors to discuss the  
9 fourth quarter and full year 2005 results. On the call, Defendant Killinger emphasized the  
10 Company's "solid quarters earnings" and its "solid performance," pointing out that the Company  
11 delivered such positive results despite the "challenges that faced [the Company]" including a  
12 difficult housing and interest rate environment. In fact, Defendant Killinger announced that  
13 "[r]eflecting our positive outlook for the future and continued solid performance, I am pleased to  
14 announce that our board of directors once again increased the cash dividend by a penny to \$0.50  
15 per share and this represents the 42nd consecutive quarter that the cash dividend has been  
16 increased."

17  
18 576. During this call, Defendants Killinger, Casey, and Rotella also reassured investors  
19 about the Company's credit performance and that the Company was actively protecting itself  
20 against credit risks and losses. For example, Killinger noted that the Company "continue[s] to  
21 experience very good credit performance." Similarly, Defendant Casey stated that "[o]ur credit  
22 quality continued to be strong for most of 2005, but *we continued to proactively manage our*  
23 *portfolio to minimize credit risk* understanding that a more difficult environment may be ahead  
24 of us." Defendant Rotella addressed WaMu's credit management practices on a loan-specific  
25 basis, stressing that for the Company's Option ARM loans: "*an important fact is we underwrite*  
26  
27

1 *every loan at the fully indexed rate. And so that's an important thing to note from a credit*  
2 *perspective."*

3 577. Similarly, at a Citigroup Financial Services Conference held on January 31, 2006,  
4 Defendant Rotella continued to tout the Company's risk management activities and stated that  
5 "[o]n the credit side, you can see we had a pretty good year. We feel like we are in good shape."  
6 In particular, Rotella assured investors and analysts who attended the conference that the  
7 Company appropriately handled the credit risk related to its Option ARM loans. When investors  
8 questioned him about the Company's exposure to "exotic" loans and asked how the Company  
9 mitigated its exposure to these loans, Defendant Rotella responded that "[t]he credit quality on  
10 those products has been quite good," that the Company does a "good job of trying to fit the right  
11 customer to that mortgage," and with regard to the Company's "pretty substantial balance sheet  
12 of option ARM products," the Company has evaluated the credit risk appropriately and "feel[s]  
13 pretty good about the credit risk."  
14  
15

16 578. On or about March 15, 2006, WaMu filed with the SEC a Form 10-K for the  
17 fourth quarter and fiscal year ended December 31, 2005. On August 9, 2006, the Company filed  
18 a Form 10-K/A with the SEC for the fourth quarter and fiscal year ended December 31, 2005  
19 (these two filings are collectively referred to as the "2005 Form 10-K"). The 2005 Form 10-K  
20 was signed by Defendants Killinger, Casey, Farrell, Woods, Frank, Pugh, Leppert, Reed, Lillis,  
21 Smith, Matthews, Stever, Murphy, Wood, and Osmer-McQuade and reiterated the materially  
22 false financial results that had been announced in the January 18, 2006 press release and earnings  
23 call.  
24

25 579. In the 2005 Form 10-K, the Company also reported a full-year provision for loan  
26 and lease losses of \$316 million in 2005, compared with a provision of \$209 million in 2004.  
27

1 According to the 2005 Form 10-K, this higher provision included \$195 million that was related  
2 to the Company's acquisition of the Company's new credit card operations in the fourth quarter.  
3 The remaining provision related to the Company's ongoing risk management efforts was \$121  
4 million. The Company also reported total assets as of December 31, 2005, of \$343.6 billion.

5  
6 580. In the 2005 Form 10-K, WaMu emphasized the Company's underwriting  
7 standards, announcing that, "[t]he Company seeks to mitigate the credit risk in this portfolio by  
8 ensuring compliance with underwriting standards on loans originated to subprime borrowers and  
9 by re-underwriting all purchased subprime loans." Similarly, WaMu promoted the quality of the  
10 credit risk management of the Company's Option ARM loan portfolio, claiming that, "The  
11 Company actively manages the credit risk inherent in its Option ARM portfolio primarily by  
12 ensuring compliance with its underwriting standards, monitoring loan performance and  
13 conducting risk modeling procedures."

14  
15 581. In addition, throughout the 2005 Form 10-K, WaMu repeatedly underscored that  
16 loan-to-value ratios were a "*key determinant of future performance*," stating:

17 Loan-to-value ratios are a key determinant of future performance. Home loans  
18 with loan-to-value ratios of greater than 80 percent at origination without private  
19 mortgage insurance or government guarantees *expose the Company to greater*  
20 *credit risk than home loans with loan-to-value ratios of 80 percent or less at*  
*origination. . . . This greater credit risk arises because, in general, both default*  
*risk and the severity of loss is higher when borrowers have less equity to protect*  
*in the event of foreclosure.*

21 582. WaMu assured investors that because credit risk was reduced when home loans  
22 had LTV ratios of less than eighty percent, the Company closely monitored its home loans with  
23 LTV ratios of greater than eighty percent. As of December 31, 2005, WaMu claimed that home  
24 loans with this increased credit risk profile amounted to \$9.01 billion, and home equity loans  
25 with this increased credit risk profile amounted to \$12.3 billion of the Company's \$229.6 of  
26 loans held in portfolio. According to the Company's 2005 Form 10-K, "Substantially all of these  
27

1 loans were made to subprime borrowers, including \$6.91 billion of purchased subprime loans.  
2 Total home loans with these features accounted for 10% of the Company's home loan volume in  
3 2005." Further, the 2005 Form 10-K stated that regarding the Company's Option ARM loans,  
4 "current loan-to-value ratios have generally improved – in many cases offsetting the credit risk  
5 associated with negative amortization that may have resulted from the borrower's use of the  
6 minimum payment option."  
7

8 583. The 2005 Form 10-K stated that "[t]he Company's financial reporting and  
9 accounting policies conform to accounting principles generally accepted in the United States of  
10 America ('GAAP')."

11 584. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
12 the information contained in the 2005 Form 10-K. These attestations were in substantially the  
13 form set forth in ¶562 above. Additionally, in signing these attestations, Defendants Killinger  
14 and Casey certified that they had designed, established, and maintained an effective system of  
15 internal controls over the Company's financial reporting.  
16

17 585. Defendants' statements in WaMu's 2005 Form 10-K that the Company was/had  
18 "mitigate[d]" or "manage[d]" its exposure to credit risk through "ensuring compliance with its  
19 underwriting standards, monitoring loan performance and conducting risk modeling procedures"  
20 were each materially false and misleading when made. Further, Defendants Killinger's, Casey's,  
21 Rotella's, and Schneider's statements in the press release, earnings call, and at the financial  
22 services conference regarding the Company's credit risk management and Option ARM lending,  
23 including that the Company does a "good job of fitting" Option ARM loans with the appropriate  
24 customers, were also false and misleading when made. The Company omitted from the 2005  
25 Form 10-K the material facts that, as set forth in detail above and as reported by numerous  
26  
27

1 Confidential Witnesses, starting in 2005 and continuing throughout the Class Period, the Officer  
2 Defendants had caused the Company's credit risk management to deteriorate significantly. For  
3 example, as set forth above, the Officer Defendants and the Company had repeatedly ignored  
4 both direct warnings and reports from senior WaMu risk management managers that the  
5 Company was operating outside of its supposed risk limits. The Company also omitted from the  
6 2005 Form 10-K the material facts that, at the same time, the Officer Defendants had caused  
7 WaMu's loan underwriting standards to become dangerously relaxed. Moreover, as detailed  
8 above, starting in 2005, WaMu encouraged its employees to make exceptions to the Company's  
9 already lenient underwriting guidelines in order to maximize WaMu's loan volume. The  
10 Company's undisclosed, lenient underwriting standards had caused the Company to increase  
11 materially its loss exposure by originating loans to less qualified borrowers. Further, as detailed  
12 above, the Company's loan-volume-focused incentive structures and the culture created by  
13 WaMu's senior management, including the Officer Defendants, had caused WaMu, through its  
14 personnel, to sell and approve riskier loans without adequately considering the quality of such  
15 loans. In addition, as discussed above, the Company failed to disclose that WaMu had secretly  
16 pressured its appraisers to inflate the stated value of the homes underlying WaMu's loans, thus  
17 manipulating the LTV ratios for WaMu's mortgages and exposing the Company to much greater  
18 credit risk than was disclosed to investors.

21  
22 586. Defendant Rotella's statement that the Company's Option ARM loans were  
23 underwritten to their fully-indexed interest rate was also materially false and misleading when  
24 made, because as set forth above, the Company had a policy of underwriting its Option ARM  
25 loans only to determine whether the borrower could pay the "teaser" monthly payment, rather  
26 than the fully-indexed payment, thus significantly increasing the risk of default. This  
27

misrepresentation was material because, as the Officer Defendants were aware and as discussed above, borrowers who were qualified for the loan at and only able to pay the monthly minimum payment were much more likely to default.

587. The Company's statements regarding LTV ratios, including the reported LTV ratios in the 2005 Form 10-K (including the statement that "current loan-to-value ratios have generally improved – in many cases offsetting the credit risk associated with negative amortization that may have resulted from the borrower's use of the minimum payment option), and Defendant Rotella's comments regarding LTV ratios at the January 31, 2006 financial services conference, were materially false and misleading when made, because as set forth above, the Company had been secretly inflating the appraisal values of the collateral underlying its home mortgage loans. This inflation materially understated the LTV ratios of the Company's loans.

588. Finally, Defendants Killinger's and Casey's certifications in the 2005 Form 10-K that the Company's financial results were reported in accordance with GAAP and that the Company maintained adequate internal controls were each materially false and misleading when made. As explained above, during the Class Period, the Company's internal controls over financial reporting suffered from significant deficiencies and material weaknesses because of, among other things, the Company's failure to address material deficiencies in its risk management, loss modeling methodology and other failures of internal controls (including those identified above in connection with Plaintiffs' allegations regarding WaMu's CRO Report). Moreover, rather than appropriately accounting for the Company's lax underwriting standards and inflated appraisals (thus signaling to the market how dangerously exposed the Company was to credit risk) or disclosing the known failures in its internal controls and Allowance



1 methodology, the Officer Defendants caused the Company to under-provision its Allowance for  
2 Loan Losses throughout the Class Period, causing the Company's net income, earnings per share,  
3 and total assets to be overstated.

4 589. Analysts responded favorably to WaMu's statements regarding the Company's  
5 credit quality. For example, in a report dated January 19, 2006, Jim Bradshaw from D.A.  
6 Davidson & Co. reported that although in the fourth quarter of 2005 the Company's earnings per  
7 share missed analysts' consensus estimates, the Company's guidance for the 2006 loan loss  
8 provision indicated sound underlying credit quality. As the report noted, "Higher operating costs  
9 and lower-than-expected revenue related to mortgage banking operations drove EPS below our  
10 expectations. This was partially offset by superior credit quality."

11  
12 **D. False & Misleading Statements**  
13 **Concerning First Quarter 2006 Results**

14 590. On April 18, 2006, WaMu issued a press release announcing its financial results  
15 for the quarter ending March 31, 2006. In this press release, WaMu reported that, for the first  
16 quarter 2006, the Company had net income of \$985 million, or \$0.98 per diluted share and total  
17 assets of \$348.7 billion. Commenting on the Company's financial results, Defendant Killinger  
18 stated: "We are very pleased with our first quarter results . . . . The company's strong  
19 performance demonstrates the benefits of our continued diversification and enhanced operational  
20 focus."  
21

22 591. In this press release, the Company also reported that its provision for loan and  
23 lease losses was \$82 million, compared to \$217 million in the fourth quarter 2005. The  
24 Company praised this performance, claiming that it was a direct result of the Company's credit  
25 quality. Specifically, the Company stated that the "[l]ower provision reflects continuing strong  
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27



1 *credit quality*” and “[s]trong credit quality results in lower provisioning.” (Emphasis in  
2 original.)

3 592. On that same day, the Company held an earnings call with investors to discuss the  
4 first quarter 2006 results. On the call, Defendant Killinger emphasized the Company’s “very  
5 good financial results across most of [the Company’s] operations, despite the difficult interest  
6 rate environment,” and emphasized that the Company was “intensely focused on quickly and  
7 effectively adjusting our operations to improve profitability in this more-challenging, lower-  
8 lending volume environment.” Defendant Killinger also announced that, for the 43rd  
9 consecutive quarter, the Board was raising the quarterly dividend by \$0.01 per share, to \$0.51.  
10

11 593. While the Officer Defendants noted that the interest rate environment continued to  
12 challenge the Company’s Home Loans business, they repeatedly praised the purportedly strong  
13 credit quality of the Company’s loan portfolio and commented on the Company’s sound  
14 performance. For example, Defendant Casey stated, “Turning to credit, we are pleased with the  
15 ongoing strong credit performance of our portfolio. The economy remains strong, and the  
16 quality of our portfolio continues to be fairly stable, with only a slight increase in non-  
17 performing assets.” In explaining the Company’s earnings driver guidance, Defendant Casey  
18 stated, “*Credit quality continues to surpass our expectations*. Given the good credit quality and  
19 provision level of this quarter, we are revising our credit provision outlook downward to \$650 to  
20 \$750 million.” In addition, when analysts specifically asked about the rising trends of  
21 repurchases in the Company’s subprime portfolio, Defendant Casey discounted the existence of  
22 any such trend, claiming, “it’s actually trending down. I think the – what we saw in the fourth  
23 quarter was a little spike. We have taken necessary actions to reduce that kind of exposure, and  
24 we feel very good about where we are right now. We don’t see that kind of trend continuing.”  
25  
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1           594. At the Company's annual shareholders meeting, also held on April 18, 2006,  
2 Defendant Casey continued to assure shareholders of the strength of the Company's loan  
3 portfolio, announcing, "Our credit provision was below our original expectation, reflecting our  
4 disciplined credit underwriting and a favorable credit environment." Casey also told  
5 shareholders that, "Lastly, our risk management strategy continues to [be] effective and our  
6 credit quality remains strong."

7  
8           595. At the D.A. Davidson & Co. Financial Services Conference on May 9, 2006,  
9 Defendant Rotella continued to reassure investors of the Company's strong credit quality, with  
10 non-performing assets at a "terrific" level and that the Company was "prudent in [its] credit  
11 extension." Defendant Rotella explained that despite the slowing housing market, the Company  
12 had seen "little evidence of any real deterioration in the consumer," but that the Company was  
13 closely monitoring the credit quality of the Company's loan portfolio through its enterprise risk  
14 management group, which gave an "independent view of how [the Company was] doing on  
15 credit risk." Defendant Rotella also touted the Company's "cushion of protection against losses  
16 going forward" in its loan portfolio provided by the portfolio's purportedly-low LTV ratios.

17  
18           596. On or about May 10, 2006, the Company filed with the SEC a Form 10-Q for the  
19 period ending March 31, 2006, which was signed by Defendants Casey and Woods. On August  
20 10, 2006, the Company filed a Form 10-Q/A with the SEC for the quarter ended March 31, 2006,  
21 which was signed by Defendant Casey (these two filings are collectively referred to as the "First  
22 Quarter 2006 Form 10-Q").

23  
24           597. The First Quarter 2006 10-Q repeated the financial results set forth in the  
25 Company's April 18, 2006 press release and earnings conference call. The First Quarter 2006  
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1 Form 10-Q also stated that “[t]he Company’s financial reporting and accounting policies  
2 conform to accounting principles generally accepted in the United States of America (‘GAAP’).”

3 598. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
4 the information contained in the First Quarter 2006 Form 10-Q. These attestations were in  
5 substantially the form set forth in ¶562 above. Additionally, the First Quarter 2006 Form 10-Q  
6 stated that “[t]here have not been any changes in the Company’s internal control over financial  
7 reporting during the first quarter of 2006 that have materially affected, or are reasonably likely to  
8 materially affect, the Company’s internal control over financial reporting.”

10 599. WaMu’s statements in the Company’s 2006 first quarter earnings release that the  
11 Company’s lower loan loss provision for the quarter was a result of “strong credit quality” were  
12 false and misleading when made. Further, Defendants Killinger’s, Casey’s, and Rotella’s  
13 statements in the earnings call and at the D.A. Davidson Financial Services Conference  
14 regarding the Company’s superior credit quality and underwriting, including the statement that  
15 the Company maintained “disciplined credit underwriting,” also were false and misleading when  
16 made. The Company omitted from the First Quarter 2006 Form 10-Q the material fact that, as  
17 set forth in detail above and as reported by numerous Confidential Witnesses, starting in 2005  
18 and continuing throughout the Class Period, the Company’s risk management efforts had  
19 deteriorated and were deficient throughout the Class Period. The Company also omitted from  
20 the First Quarter 2006 Form 10-Q the material facts that, as set forth above and as reported by  
21 numerous Confidential Witnesses, starting in 2005 and continuing throughout the Class Period,  
22 the Officer Defendants had caused the Company’s credit risk management to deteriorate  
23 significantly. For example, as set forth above, the Officer Defendants and the Company had  
24 repeatedly ignored both direct warnings and reports from senior WaMu risk management  
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1 managers that the Company was operating outside of its supposed risk limits. Furthermore, the  
2 Company's underwriting standards, as described in detail above, were inappropriately permissive  
3 and lax. Moreover, as detailed above, starting in 2005, WaMu encouraged its employees to  
4 make exceptions to the Company's already lenient underwriting guidelines in order to maximize  
5 WaMu's loan volume. The Company's undisclosed, lenient underwriting standards had caused  
6 the Company to increase materially its loss exposure by originating loans to less qualified  
7 borrowers. In addition, as detailed above, the Company's loan-volume-focused incentive  
8 structures and the culture created by WaMu's senior management, including the Officer  
9 Defendants, had caused WaMu, through its personnel, to sell and approve riskier loans without  
10 adequately considering the quality of such loans. Further, as discussed above, the Company  
11 failed to disclose that WaMu had secretly pressured its appraisers to inflate the stated value of the  
12 homes underlying WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages and  
13 exposing the Company to much greater credit risk than was disclosed to investors.  
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15  
16 600. Finally, the Company's statements in the 2006 First Quarter Form 10-Q that the  
17 Company's financial results were reported in accordance with GAAP and that the Company  
18 maintained adequate internal controls were each materially false and misleading when made. As  
19 explained above, during the Class Period, the Company's internal controls over financial  
20 reporting suffered from significant deficiencies and material weaknesses because of, among  
21 other things, the Company's failure to address material deficiencies in its risk management, loss  
22 modeling methodology and other failures of internal controls (including those identified above in  
23 connection with Plaintiffs' allegations regarding WaMu's CRO Report). Moreover, rather than  
24 appropriately accounting for the Company's lax underwriting standards and inflated appraisals  
25 (thus signaling to the market how dangerously exposed the Company was to credit risk) or  
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disclosing the known failures in its internal controls and Allowance methodology, the Officer Defendants caused the Company to under-provision its Allowance for Loan Losses throughout the Class Period, causing the Company's net income, earnings per share, and total assets to be overstated. Furthermore, as discussed above, in the first quarter of 2006 WaMu under-provisioned the Company's loss reserves by an estimated amount of at least \$90 million, or 52%. WaMu's GAAP violations had the effect of overstating the Company's reported net income for first quarter 2006 by an estimated amount of at least \$33 million, or 3%. Likewise, the Company's diluted earnings per share was overstated by an estimated amount of at least \$0.03 for the first quarter 2006.

601. Analysts responded favorably to WaMu's statements regarding the Company's credit quality. For example, Bradley Ball from Citigroup in a report dated April 18, 2006, noted that in the Company's first quarter of 2006, "[t]he main source of strength was in credit . . . . While management tweaked guidance to reflect changing market conditions – incl[uding] a lower for longer NIM [net interest margin] and higher MSR hedging cost, *improved credit* and expense management should offset . . . . our full year EPS estimates are unchanged."

**E. Defendants' False & Misleading Statements at the  
May 18, 2006, Lehman Brothers Ninth Annual Financial  
Services Conference and the June 1, 2006  
Sanford C. Bernstein & Co. Strategic Decisions Conference**

602. On May 18, 2006, Defendant Killinger attended the Lehman Brothers Ninth Annual Financial Services Conference, where he repeated his false statements regarding the purported strength of the Company's loan portfolio. For example, Defendant Killinger dismissed concerns about credit, stating "The next target is on the credit front. . . . Certainly we can come back in the Q&A if you want to talk more about credit; but credit for us is [in] excellent shape, and *I feel very comfortable with where we are from management of that credit as well as the*

1 *reserving.*” Further, speaking on the Company’s risk management efforts, Defendant Killinger  
2 announced, “So I would say this is a point in the [housing] cycle in which you control what you  
3 can; you get the ship in good shape[.]”

4 603. On June 1, 2006, Defendant Killinger attended the Sanford C. Bernstein & Co.  
5 Strategic Decisions Conference, where he continued to reassure investors of the strong credit  
6 quality of the Company’s loan portfolio, stating, “*on the credit front, we continue to be in*  
7 *excellent shape.*” In addition, in response to a question regarding negative amortization and  
8 credit quality, Defendant Killinger declared that he had been “a resident bear” on housing from  
9 “over a year” before, stating that the Company began to take “more conservative actions at that  
10 time.” After touting the Company’s “defensive actions” taken in response to Defendant  
11 Killinger’s concerns about “speculative activity” in the market, Defendant Killinger downplayed  
12 concerns about negative amortization, stating, “in our existing portfolio of option ARMs, our  
13 average FICO score is about a 710 and our loan to value at originations was 71%. And based on  
14 today’s market price we estimate that the loan to value of the portfolio is about 57%.” Defendant  
15 Killinger also lauded the Company’s experience with these exotic loans, stating, “The other  
16 comment I would make is that we have experience of marketing and managing portfolios of  
17 adjustable rate loans for well over 20 years; and we have the data about how these loans  
18 performed through various parts of the economic cycle and so far the performance has been right  
19 in line with expectations and I just haven’t seen anything to cause us any particular concerns.”

20 604. Defendant Killinger’s statements at the Lehman Brothers Financial Services  
21 Conference and the Sanford C. Bernstein & Co. Strategic Decisions Conference regarding the  
22 Company’s superior credit quality, underwriting, and reserving were false and misleading when  
23 made. Defendant Killinger’s statements regarding the Company’s supposed preparedness for a  
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1 housing turndown, the LTV ratios in the Company's Option ARM portfolio, and the Company's  
2 careful approach in marketing and managing the exotic Option ARM loans were also false and  
3 misleading when made. As set forth above and as reported by numerous Confidential Witnesses,  
4 stating in 2005 and continuing throughout the Class Period, the Company's risk management  
5 efforts had deteriorated and were deficient throughout the Class Period. during 2005 and  
6 throughout the Class Period, the Company's risk management efforts had deteriorated and were  
7 grossly deficient throughout the Class Period. For example, as set forth above, the Officer  
8 Defendants and the Company repeatedly ignored both direct warnings and reports from senior  
9 WaMu risk management managers that the Company was operating outside of its supposed risk  
10 limits. Further, WaMu did not employ strict or prudent underwriting standards during the Class  
11 Period. In fact, as detailed above, the Officer Defendants caused WaMu's loan underwriting  
12 standards to become dangerously relaxed. Moreover, as detailed above, starting in 2005, WaMu  
13 encouraged its employees to make exceptions to the Company's already lenient underwriting  
14 guidelines in order to produce a greater volume of loans. The Company's undisclosed, lenient  
15 underwriting policies and practices caused the Company to increase materially its loss exposure  
16 by originating loans to less qualified borrowers. Further, the Company's loan-volume-based  
17 incentive structures and the culture created by WaMu's senior management, including the Officer  
18 Defendants, caused WaMu's salespeople to originate more loans without regard to the quality of  
19 such loans. Further, as discussed above, WaMu secretly pressured its appraisers to inflate the  
20 stated value of the homes underlying these loans, thus manipulating the LTV ratios for WaMu's  
21 mortgages and exposing the Company to much greater credit risk than was disclosed to  
22 investors. Additionally, as discussed above, internal, non-public documents obtained through  
23 Lead Plaintiff's investigation reveal that the Company was not capable of assessing or  
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adequately controlling its credit risk with regard to the Company's Option ARM loans. Thus, Defendant Killinger's comments reassuring investors that the Company's Option ARM portfolio was not a danger were false and misleading when made.

**F. False & Misleading Statements  
Concerning Second Quarter 2006 Results**

605. On July 19, 2006, WaMu issued a press release announcing its financial results for the quarter ending June 30, 2006. In this press release, WaMu reported that, for the second quarter 2006, the Company had net income of \$767 million, or \$0.79 per diluted share and total assets of \$350.7 billion. In this press release, the Company also reported that its provision for loan and lease losses was \$224 million, compared to \$82 million in the first quarter 2006. The Company explained that this heightened provision was primarily the result of the Company's new credit card business and attributed the remainder to "a modest increase in the level of charge-offs, as well as incremental loan growth." The allocated provision for the Retail Banking Group and the Home Loans Group, where the prime residential portfolio and the subprime portfolio resided, respectively, totaled only \$38 million, compared with the \$417 million provision allocated to the Card Services Group.

606. On that same day, the Company held an earnings call with investors to discuss the second quarter 2006 results. On the call, Defendant Killinger announced a "major acceleration point in the ongoing transformation of our business," which included a \$2.6 billion sale of mortgage servicing rights and other adjustments. Defendant Killinger placed great emphasis on the steps taken, saying, "Now, I can't overemphasize the significance of these actions for us. Improving our operating efficiency, reducing the market volatility of our earnings and refocusing our Home Loans units on higher margin businesses will increase the core profitability of the Company. And this will position us even better for the leverage which is inherent in our business



1 model when the interest rate environment improves.” Without those adjustments, Defendant  
2 Killinger announced that earnings per share would have been \$0.94, compared with \$0.95 a  
3 share in the second quarter of 2005. Once again, Defendant Killinger announced that for the  
4 44th consecutive quarter the Board was raising the quarterly dividend by \$0.01 per share, to  
5 \$0.52.

6  
7 607. On that earnings call, while the Officer Defendants continued to note the  
8 challenging interest rate environment in which the Company operated, Defendant Casey touted  
9 the “*strong ongoing stability and strength of the [loan] portfolio*,” announcing that “[c]*redit*  
10 *quality continues to be strong*” and that “Option ARMs continue to be a good, strong leader for  
11 us.” Defendant Rotella agreed that, with regard to the subprime portfolio, Defendants “[felt] like  
12 we’ve got the right pricing and the *right credit profile in the marketplace*,” while Option ARMs  
13 “continue[d] to be [the Company’s] flagship product.” In response to specific inquiries regarding  
14 deterioration in the credit quality of the subprime portfolio, Defendant Rotella downplayed any  
15 degradation in credit quality and noted the Company’s careful monitoring of its loan portfolio,  
16 replying:

17  
18 Generally, we think the consumer is healthy. . . . And we fell [sic] pretty good  
19 about that as the quarters have developed. So we don’t see anything significant  
20 happening in the sector. . . . With that said, we’re being quite careful and making  
21 any changes we need to make in our credit policies as we move forward, but our  
22 sense of things are – things are in pretty good shape.

23 608. On or about August 9, 2006, the Company filed with the SEC a Form 10-Q for the  
24 period ending June 31, 2006, which was signed by Defendants Casey and Woods. (the “Second  
25 Quarter 2006 Form 10-Q”). The Second Quarter 2006 10-Q repeated the financial results set  
26 forth in the Company’s July 19, 2006 press release and earnings conference call. The Second  
27 Quarter 2006 Form 10-Q also stated that “[t]he Company’s financial reporting and accounting

1 policies conform to accounting principles generally accepted in the United States of America  
2 ('GAAP')."

3 609. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
4 the information contained in the Second Quarter 2006 Form 10-Q. These attestations were in  
5 substantially the form set forth in ¶562 above. Additionally, the Second Quarter 2006 contained  
6 a statement confirming the adequacy of the Company's internal controls over financial reporting  
7 in substantially the form set forth in ¶563 above.  
8

9 610. The Company's statements in WaMu's 2006 second quarter earnings release and  
10 Defendants Killinger's, Casey's, and Rotella's statements during the 2006 second quarter  
11 earnings call regarding the "strong ongoing stability and strength of the portfolio," that the  
12 "consumer is healthy," and that the Company had the "right credit profile in the marketplace,"  
13 were false and misleading when made. The Company omitted from Second Quarter 2006 Form  
14 10-Q the material facts that, as set forth in detail above and as reported by numerous  
15 Confidential Witnesses, starting in 2005 and continuing throughout the Class Period, the Officer  
16 Defendants had caused the Company's credit risk management to deteriorate significantly. For  
17 example, as set forth above, the Officer Defendants and the Company had repeatedly ignored  
18 both direct warnings and reports from senior WaMu risk management managers that the  
19 Company was operating outside of its supposed risk limits. Furthermore, the Company's  
20 underwriting standards, as described in detail above, were inappropriately permissive and lax.  
21 Moreover, as detailed above, starting in 2005, WaMu encouraged its employees to make  
22 exceptions to the Company's already lenient underwriting guidelines in order to maximize  
23 WaMu's loan volume. The Company's undisclosed, lenient underwriting standards had caused  
24 the Company to increase materially its loss exposure by originating loans to less qualified  
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1 borrowers. In addition, as detailed above, the Company's loan-volume-focused incentive  
2 structures and the culture created by WaMu's senior management, including the Officer  
3 Defendants, had caused WaMu, through its personnel, to sell and approve riskier loans without  
4 adequately considering the quality of such loans. Further, as revealed in detail above, the  
5 Company failed to disclose that WaMu secretly had pressured its appraisers, including, as  
6 discussed above, its third-party appraisers, to inflate the stated value of the homes underlying  
7 WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages and exposing the  
8 Company to much greater credit risk than was disclosed to investors.

10 611. Finally, Defendants Killinger's and Casey's statements in the 2006 Second  
11 Quarter Form 10-Q that the Company's financial results were reported in accordance with GAAP  
12 and that the Company maintained adequate internal controls were each materially false and  
13 misleading when made. As explained above, during the Class Period, the Company's internal  
14 controls over financial reporting suffered from significant deficiencies and material weaknesses  
15 because of, among other things, the Company's failure to address material deficiencies in its risk  
16 management, loss modeling methodology and other failures of internal controls (including those  
17 identified above in connection with Plaintiffs' allegations regarding WaMu's CRO Report).  
18 Moreover, rather than appropriately accounting for the Company's lax underwriting standards  
19 and inflated appraisals (thus signaling to the market how dangerously exposed the Company was  
20 to credit risk) or disclosing the known failures in its internal controls and Allowance  
21 methodology, the Officer Defendants caused the Company to under-provision its Allowance for  
22 Loan Losses throughout the Class Period, causing the Company's net income, earnings per share,  
23 and total assets to be overstated. Furthermore, as discussed above, in the second quarter 2006  
24 WaMu under-provisioned the Company's loss reserves by an estimated amount of at least \$60  
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1 million, or 21%. WaMu's GAAP violations had the effect of overstating the Company's reported  
2 net income for second quarter 2006 by an estimated amount of at least \$49 million, or 6%.  
3 Likewise, the Company's diluted earnings per share was overstated by an estimated amount of at  
4 least \$0.05 for the second quarter 2006.

5  
6 **G. Defendants' False & Misleading Statements at**  
7 **WaMu's 2006 Investor Day And at the**  
8 **Lehman Brothers 4th Annual Conference**

9 612. At the Company's annual Investor Day conference, held on September 6 and 7,  
10 2006, the Officer Defendants continued to laud the credit quality of WaMu's loan portfolios and  
11 the Company's "*strong underwriting*," "*conservative lending standards*," "*rigorous credit*  
12 *standards*," and "*a disciplined credit culture*." Specifically, regarding the Company's Option  
13 ARM portfolio, Defendant Cathcart noted that, "At origination, WaMu focuses on an effective  
14 underwriting process and borrower disclosures[.]" Hence, "[w]ith respect to the borrower, the  
15 portfolio quality is very sound." In fact, Defendant Cathcart discounted the effect of negative  
16 amortization and its impact on the Company's risk exposure due to WaMu's effective  
17 underwriting, explaining that, "Even after maximum negative amortization and with no home  
18 price appreciation, the portfolio should remain well secured and the borrower should have  
19 sufficient equity to refinance, should they choose to do so." Defendant Cathcart concluded that,  
20 for Option ARM borrowers, "WaMu controls the underwriting, so we have the opportunity to  
21 evaluate the borrower at the time of origination. Overall, we are comfortable with this  
22 portfolio."

23  
24 613. At the Company's Investor Day, the Officer Defendants also emphasized their  
25 preparation for the softer housing market that mortgage lenders widely were experiencing.  
26 Specifically, Defendant Killinger stated, "For WaMu, a slowdown in housing will no doubt lead  
27

1 to higher delinquencies and credit cost, and again, we factor that into our planning. However, as I  
2 alluded to earlier, we began planning for this quite some time ago, took a number of defensive  
3 actions. And so, I believe that we are very well positioned, regardless of what happens in the  
4 housing market.” Defendant Schneider stated:

5       On subprime, we have seen, as others have seen, some early payment default and  
6 repurchase activity. We saw most of that occur for us in late ‘05, Q4 ‘05, and first  
7 quarter of ‘06. We *reserved for it appropriately* and we have also, in second  
8 quarter of ‘06, *tightened up a number of our underwriting guidelines*, and you  
can see that in our numbers.”

9       In fact, we think we’ve lost probably a percentage or so of market share over the  
10 past year as a result of tightening some of the credit guidelines in our subprime  
11 business. And we think that was the prudent thing to do and actually we think  
we’re ahead of many of our competitors here.

12       614. Defendant Rotella, stressing his own personal experience through many housing  
13 cycles, announced that although it was a challenging mortgage environment, the Officer  
14 Defendants “[felt] good about the fact that we’ve been aggressive in controlling what we can  
15 control. Frankly, we’ve been ahead of the market in my perspective.” Further, Defendant  
16 Cathcart, in an in-depth presentation regarding the Company’s purportedly thorough risk  
17 management, noted, “we have been watching our credit profile diligently for the last two years,  
18 and we’ve been making strategic choices to prepare for the environment we currently find  
19 ourselves in.”

20       615. At the Investor Day, analysts questioned the Officer Defendants regarding the  
21 Company’s decision to use third-party appraisers. In response, the Officer Defendants explained  
22 that the Company’s decision was made because it gave the Company “better quality.” Defendant  
23 Killinger added, “there’s a very strong governance process over those external appraisers.”

24       616. On September 13, Defendant Killinger participated in the Lehman Brothers 4th  
25 Annual Conference. At that conference, Defendant Killinger made numerous false and  
26  
27

misleading statements concerning the Company's credit portfolio and underwriting, including stating that "*on the credit front, we're in excellent shape*," which Defendant Killinger attributed to the purported fact that "*we have been preparing for a more difficult environment for some time*." Defendant Killinger emphasized that the Company had "*started to prepare for a slowing period*" by taking a number of steps to unload high-risk assets, "*as well as having appropriate level of reserving*." With regard to the threat of negative amortization to income quality, Defendant Killinger stated, "Well, the entire amount of negative amortization in this portfolio is only 69 basis points. So the way I look at it from a credit side is I have a loan-to-value against current value of houses of around 56%; 69 basis points is a very, very small fraction of that total exposure to that level of properties."

617. Defendants Killinger's, Rotella's, Schneider's, and Cathcart's statements in WaMu's Investor Day and at the Lehman Brothers' conference regarding the Company's "strong underwriting," "conservative lending standards," including the Company's supposed "rigorous credit standards," "disciplined credit culture," that credit was "in excellent shape," and that the Company's purported LTV ratios would cushion the Company from credit risk in its Option ARM portfolio, were false and misleading when made. As set forth above and as attested to by numerous Confidential Witnesses, stating in 2005 and continuing throughout the Class Period, the Company's risk management efforts had deteriorated and were grossly deficient throughout the Class Period. For example, as set forth above, the Officer Defendants and the Company repeatedly ignored both direct warnings and reports from senior WaMu risk management managers that the Company was operating outside of its supposed risk limits. Further, WaMu did not employ strict or prudent underwriting standards during the Class Period. In fact, as detailed above, the Officer Defendants caused WaMu's loan underwriting standards to become

1 dangerously relaxed. Moreover, as detailed above, starting in 2005, WaMu encouraged its  
2 employees to make exceptions to the Company's already lenient underwriting guidelines in order  
3 to produce a greater volume of loans. The Company's undisclosed, lenient underwriting policies  
4 and practices caused the Company to increase materially its loss exposure by originating loans to  
5 less qualified borrowers. Further, the Company's loan-volume-based incentive structures and the  
6 culture created by WaMu's senior management, including the Officer Defendants, caused  
7 WaMu's salespeople to originate more loans without regard to the quality of such loans.  
8 Further, as discussed above, the Company failed to disclose that WaMu secretly pressured its  
9 appraisers, including, as discussed above, its third-party appraisers, to inflate the stated value of  
10 the homes underlying WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages  
11 and exposing the Company to much greater credit risk than was disclosed to investors.  
12

13  
14 618. Further, Defendants Killinger's, Rotella's and Cathcart's statements at the  
15 Investor Day and at the Lehman Brothers conference that the Company had been monitoring the  
16 credit quality of its portfolio for any weaknesses and were preparing for the housing crisis, were  
17 "aggressive in controlling what [the Company could] control," "tightening guidelines" and had  
18 been preparing the Company by "having the appropriate level of reserving" were false and  
19 misleading when made. Rather, as noted above, the Company had dangerously relaxed the  
20 cornerstone of loan origination over which it had the most control – that is, WaMu's  
21 underwriting. Indeed, the Company ostensibly did not have control over appraisal values for the  
22 collateral for its loans, and yet, as explained above, it improperly influenced that process in order  
23 to improperly attain low LTV ratios and close more loans. In addition, the Company's risk  
24 management efforts had deteriorated and were deficient throughout the Class Period. For  
25 example, as set forth above, the Officer Defendants and the Company repeatedly ignored both  
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1 direct warnings and reports from senior WaMu risk management managers that the Company  
 2 was operating outside of its supposed risk limits. Further, as discussed above, the Company did  
 3 not have the “appropriate level of reserving” during the Class Period because, as the Officer  
 4 Defendants knew or recklessly disregarded, the Company did not possess an adequate method for  
 5 determining its Allowance, nor did the Allowance appropriately account for the deteriorating  
 6 credit quality of its loans caused by the Company’s fraudulent underwriting, improper appraisal  
 7 and poor risk management practices. Moreover, as explained by CW 79, who personally met  
 8 with Defendants Killinger, Cathcart, Rotella, and Casey in preparation for the Company’s annual  
 9 Investor Day held in September 2006, during which Defendants made numerous false and  
 10 misleading statements, and as discussed above, Defendants Killinger, Cathcart, Rotella, and  
 11 Casey were fully aware of or recklessly disregarded the poor and degenerating credit quality of  
 12 WaMu’s loan portfolio when they made those statements.  
 13  
 14

15 **H. False & Misleading Statements**  
 16 **Concerning Third Quarter 2006 Results**

17 619. On October 18, 2006, WaMu issued a press release announcing its financial  
 18 results for the quarter ending September 30, 2006. In this press release, WaMu reported that, for  
 19 the third quarter 2006, the Company had net income of \$748 million, or \$0.77 per diluted share  
 20 and total assets of \$348.9 billion. In this press release, the Company also reported that its  
 21 provision for loan and lease losses was \$166 million, compared to \$224 million in the second  
 22 quarter 2006. The Company emphasized that “Credit exposure continues to be proactively  
 23 managed,” and the “Company conservatively manages [its] balance sheet.”  
 24

25 620. On that same day, the Company held an earnings call with investors to discuss the  
 26 third quarter 2006 results. On the call, Defendant Killinger announced, “Despite the challenging  
 27 environment impacting the mortgage banking industry, we feel good about the proactive steps we  
 28



1 have taken. Our portfolio remains in very good shape and non-performing assets remain very  
2 low.” Indeed, Defendant Killinger again emphasized that they had been preparing for a slowing  
3 housing market for several years: “The housing market is clearly weakening with the pace of  
4 housing price appreciation slowing in most regions of the country. . . . [H]owever, we began  
5 preparing for this possibility quite some time ago and took defensive actions to strengthen our  
6 portfolio. So we believe we are well prepared to weather the more difficult credit environment.”  
7 Once again, Defendant Killinger announced that the Board was raising the per share dividend by  
8 \$0.01 a share for the 45th consecutive quarter, to \$0.53.

10 621. According to Defendant Casey, the Company conscientiously monitored the  
11 Company’s reserving for credit losses. During the Company’s third quarter 2006 earnings call,  
12 Defendant Casey similarly stressed, “We do reviews of our provision throughout the year and our  
13 [Allowance for Loan and Lease Losses] every single quarter and this quarter was no different  
14 from any other quarter. We continue to look at all of our loss factors and the performance of  
15 underlying portfolio and continually make adjustments.”

17 622. Defendant Killinger continued to stress the quality, in particular, of the  
18 Company’s Option ARM portfolio. In the earnings call on October 18, 2006, Defendant  
19 Killinger highlighted the Company’s years of experience with the Option ARM product:

20 We have more than 20 years experience underwriting and originating option ARM  
21 loans through many market cycles. We understand that the best mortgage  
22 customer is a well-informed borrower and that’s why we focus on providing clear,  
23 understandable disclosures for our customers and ongoing training for our sales  
24 force. . . . [T]he quality of our option ARM portfolio remains strong.

26 623. Further, Defendant Killinger emphasized that the Company underwrote its Option  
27 ARM loans to the fully-indexed rate, stating: “Let me make one clear point. In our underwriting  
28

1 on option ARMs we underwrite to the fully indexed rate, we never underwrite to the teaser rate.  
2 And so, again, we don't see this as having a significant impact on the underwriting for us."

3 624. On or about November 9, 2006, the Company filed with the SEC a Form 10-Q for  
4 the period ending September 30, 2006, which was signed by Defendants Casey and Woods. (the  
5 "Third Quarter 2006 Form 10-Q"). The Third Quarter 2006 10-Q repeated the financial results  
6 set forth in the Company's October 18, 2006 press release and earnings conference call. The  
7 Third Quarter 2006 Form 10-Q also stated that "[t]he Company's financial reporting and  
8 accounting policies conform to accounting principles generally accepted in the United States of  
9 America ('GAAP')."

11 625. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
12 the information contained in the Third Quarter 2006 Form 10-Q. These attestations were in  
13 substantially the form set forth in ¶562 above. Additionally, the Third Quarter 2006 Form 10-Q  
14 contained a statement confirming the adequacy of the Company's internal controls over financial  
15 reporting in substantially the form set forth in ¶563 above.

17 626. WaMu's and Defendant Killinger's statements in WaMu's 2006 third quarter  
18 earnings release and during calls with investors, claiming that "credit exposure continues to be  
19 proactively managed," that the "Company conservatively manages [its] balance sheet," that the  
20 "portfolio remains in very good shape," and that regarding credit, the Company was "in great  
21 shape," and "in very good shape" were false and misleading when made. Further, Defendant  
22 Killinger's numerous statements stressing the Company's efforts to prepare for a housing crunch  
23 were false and misleading when made. The Company omitted from the Third Quarter Form 10-  
24 Q the material facts that, as set forth above and as reported by numerous Confidential Witnesses,  
25 starting in 2005 and continuing throughout the Class Period, the Officer Defendants had caused  
26  
27

1 the Company's credit risk management to deteriorate significantly. For example, as set forth  
2 above, the Officer Defendants and the Company had repeatedly ignored both direct warnings and  
3 reports from senior WaMu risk management managers that the Company was operating outside  
4 of its supposed risk limits. Furthermore, the Company's underwriting standards, as described in  
5 detail above, were inappropriately permissive and lax. Moreover, as detailed above, starting in  
6 2005, WaMu encouraged its employees to make exceptions to the Company's already lenient  
7 underwriting guidelines in order to maximize WaMu's loan volume. The Company's  
8 undisclosed, lenient underwriting standards had caused the Company to increase materially its  
9 loss exposure by originating loans to less qualified borrowers. Further, as detailed above, the  
10 Company's loan-volume-focused incentive structures and the culture created by WaMu's senior  
11 management, including the Officer Defendants, had caused WaMu, through its personnel, to sell  
12 and approve riskier loans without adequately considering the quality of such loans. Further, as  
13 revealed in detail above, the Company failed to disclose that WaMu secretly had pressured its  
14 appraisers, including, as discussed above, its third-party appraisers, to inflate the stated value of  
15 the homes underlying WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages  
16 and exposing the Company to much greater credit risk than was disclosed to investors.

19 627. Additionally, Defendant Casey's statements regarding their purported method for  
20 determining the Company's provision for loan and lease losses, as well as Defendants'  
21 statements in the 2006 Third Quarter Form 10-Q that the Company's financial results were  
22 reported in accordance with GAAP and that the Company maintained adequate internal controls  
23 were each materially false and misleading when made. As explained above, during the Class  
24 Period, the Company's internal controls over financial reporting suffered from significant  
25 deficiencies and material weaknesses because of, among other things, the Company's failure to  
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1 address material deficiencies in its risk management, loss modeling methodology and other  
2 failures of internal controls (including those identified above in connection with Plaintiffs’  
3 allegations regarding WaMu’s CRO Report). Moreover, rather than appropriately accounting for  
4 the Company’s lax underwriting standards and inflated appraisals (thus signaling to the market  
5 how dangerously exposed the Company was to credit risk) or disclosing the known failures in its  
6 internal controls and Allowance methodology, the Officer Defendants caused the Company to  
7 under-provision its Allowance for Loan Losses throughout the Class Period, causing the  
8 Company’s net income, earnings per share, and total assets to be overstated. Furthermore, as  
9 discussed above, in the third quarter 2006, the Officer Defendants under-provisioned the  
10 Company’s loss reserves by an estimated amount of at least \$241 million, or 59%. WaMu’s  
11 GAAP violations had the effect of overstating the Company’s reported net income for third  
12 quarter 2006 by an estimated amount of at least \$157 million, or 21%. Likewise, the Company’s  
13 diluted earnings per share was overstated by an estimated amount of at least \$0.16 for the third  
14 quarter 2006.

17 **I. Defendants’ False & Misleading Statements at the Merrill**  
18 **Lynch & Goldman Sachs Financial Services Conferences**

19 628. On November 16, 2006, Defendant Killinger attended a Merrill Lynch Banking &  
20 Financial Services Conference. At that conference, Defendant Killinger stressed the quality of  
21 the Company’s Option ARM portfolio, noting that “Our option ARM portfolio quality is also  
22 very good[.]” At the same conference, Defendant Killinger again emphasized, “I’m telling you  
23 from our 20 – over 20 years’ experience in the option ARM product that [negative amortization]  
24 is – has not historically been a significant factor for us and we’re very comfortable, again, where  
25 we are with our loan-to-value.” At the conference, Defendant Killinger repeatedly attributed the  
26 quality of its Option ARM portfolio to the Company’s practice of underwriting the Option ARM  
27

1 loans to their fully amortizing payments. For example, Defendant Killinger stated: “Our option  
2 ARM portfolio quality is also very good . . . . This quality reflects the option ARM underwriting  
3 which evaluates the borrower’s ability to make the loans fully amortizing payments, even though  
4 they are allowed to make a much lower initial payment.”

5  
6 629. On December 13, 2006, Defendant Killinger also attended a Goldman Sachs  
7 Financial Services CEO Conference, where he once again stressed the Company’s preparation  
8 for changes in the housing environment, stating that, “On the credit front, we’re in very good  
9 shape[.]” Defendant Killinger continued,

10 Clearly our credit performance has been outstanding over the last several years.  
11 This is in part because we started preparing some time ago for a more difficult  
12 credit environment. If anything, I can be accused of being too conservative. And  
13 perhaps we could have maximized our profitability even more by taking on more  
14 credit risk through this period of very benign credit. But we want to stay ahead of  
15 the curve, be a little more conservative.”

16 630. At the Goldman Sachs conference, Defendant Killinger further claimed to  
17 consider relevant data regarding loan delinquencies and defaults, as well as the general mortgage  
18 environment, when provisioning for loan losses: “On the credit provisioning assumptions, we  
19 have assumed in our models all of the data that we see so far, which is an assumption of a  
20 slowing economy and increasing delinquencies in most categories, especially in things like sub-  
21 prime and in some of the other mortgage products.” In response to specific inquiries regarding  
22 the Company’s loan loss provisioning, Defendant Killinger again stated,

23 When we do our reserving, I will tell you that we factor in the existing book of  
24 business; what the current delinquencies are; we make assumptions about housing  
25 price declines and the economy; and we develop models about what we think is  
26 going to happen to delinquencies, ultimate charge-offs. And those things are,  
27 clearly, rising right now. And then we back that into what’s the appropriate  
28 amount of embedded losses in that portfolio, and that determines our reserving.  
We do that every quarter.”

631. Defendant Killinger's statements at the Merrill Lynch and Goldman Sachs financial services conferences regarding the quality of the Company's loan portfolios were false and misleading when made. Further, Defendant Killinger's numerous statements stressing the Company's efforts to prepare for a housing crunch were false and misleading when made. As set forth above and as attested to by numerous Confidential Witnesses, stating in 2005 and continuing throughout the Class Period, the Company's risk management efforts had deteriorated and were grossly deficient throughout the Class Period. For example, as set forth above, the Officer Defendants and the Company repeatedly ignored both direct warnings and reports from senior WaMu risk management managers that the Company was operating outside of its supposed risk limits. Further, WaMu did not employ strict or prudent underwriting standards during the Class Period. In fact, as detailed above, the Officer Defendants caused WaMu's loan underwriting standards to become dangerously relaxed. Moreover, as detailed above, starting in 2005, WaMu encouraged its employees to make exceptions to the Company's already lenient underwriting guidelines in order to produce a greater volume of loans. The Company's undisclosed, lenient underwriting policies and practices caused the Company to increase materially its loss exposure by originating loans to less qualified borrowers. Further, the Company's loan-volume-based incentive structures and the culture created by WaMu's senior management, including the Officer Defendants, caused WaMu's salespeople to originate more loans without regard to the quality of such loans. Further, as discussed above, the Company failed to disclose that WaMu secretly pressured its appraisers, including, as discussed above, its third-party appraisers, to inflate the stated value of the homes underlying WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages and exposing the Company to much greater credit risk than was disclosed to investors.

632. Additionally, Defendant Killinger's comments at the Goldman Sachs' conference regarding the quality of the Company's reserving were materially false and misleading. For example, as set forth above, Defendant Killinger knew or recklessly disregarded but failed to disclose the material fact that, well into 2006, WaMu's key model for calculating the appropriate provisions for the Allowance, the LPRM, was not designed or able to account properly for losses on Option ARM loans and other WaMu products with the potential to "negatively amortize," and thus the Company's evaluation of incurred and probable loan losses was materially understated. Defendant Killinger also knew or recklessly disregarded but omitted the material fact that the LPRM did not take into account the ongoing deteriorating loan quality of the Company's loan portfolio in calculating incurred and probable losses.

**J. False & Misleading Statements Concerning  
Fourth Quarter & Year-End 2006 Results**

633. On January 17, 2007, WaMu issued a press release announcing its financial results for the quarter and year-ended December 31, 2006. In this press release, WaMu reported that, for the fourth quarter 2006, the Company's reported net income of \$1.06 billion, or \$1.10 per diluted share, compared with net income of \$865 million, or \$0.85 per diluted share, in the fourth quarter of 2005. For the full year 2006, the Company's reported net income was \$3.56 billion, or \$3.64 per diluted share, compared with a net income of \$3.43 billion, or \$3.73 per diluted share, in 2005. The Company reported total assets as of December 31, 2006, of \$346.3 billion. WaMu also reported that its provision for loan and lease losses for the fourth quarter 2006 was \$344 million, \$95 million of which the Company attributed to the Company's on-balance sheet credit card receivables. The full-year 2006 loan loss provision of \$816 million, an increase of \$500 million over the 2005 provision that the Company stated in its earnings release was "primarily due to the addition of the company's credit card business acquired Oct. 1, 2005."



1 In the press release, Defendant Killinger stated that the Company's "outlook for 2007 reflects the  
2 strategic actions we took in 2006 to prepare the company for the future. Those decisive actions  
3 have positioned us well to deliver stronger operating performance in 2007."

4 634. On that same day, the Company held an earnings call with investors to discuss the  
5 fourth quarter and year-end 2006 results. During this call, the Officer Defendants noted the  
6 difficult environment for mortgage lenders, but, in doing so, Defendant Killinger emphasized the  
7 Company's preparedness due its strict underwriting practices, among other things. Specifically,  
8 Defendant Killinger explained:  
9

10 As you'll recall I have been pretty pessimistic on the housing market for the last  
11 couple of years, and really felt that the market was overheated and was likely to  
12 be slowing at some point, and so both the combination of that and also from a  
13 strategic standpoint we've been diversifying our mix of businesses . . . **We**  
14 **tightened underwriting**, we decreased production volume by about half in the  
15 subprime area taking ourselves down from the sixth largest originator all the way  
down to ten, and we decreased the subprime portfolio you were asking about by  
about \$2.4 billion over the last twelve months, and I think the important thing is  
that as the housing market has softened as expected, what I have really seen is a  
continued very good performance out of most parts of the portfolio.

16 Defendant Killinger reassured investors that, although the Company had stated its intention to  
17 focus on higher-margin mortgage products in the past, it had promised to do so only in a  
18 "prudent manner." In addition, Defendant Killinger also announced that for the 46th consecutive  
19 quarter the Board was raising the quarterly dividend by \$0.01 a share, to \$0.54.

20 635. After the Company's earnings announcement on January 17, 2007, the stock price  
21 of the Company's common shares rose from a close of \$44.06 on January 16 to \$45.31 on  
22 January 26.

23 636. At the Citigroup 2007 Financial Services Conference held on January 30, 2007,  
24 Defendant Killinger continued to falsely reassure investors that the credit quality of the  
25 Company's loan portfolio "continue[d] to be in very good shape," specifically emphasizing the  
26  
27



1 “high quality” of the Company’s prime loans, the “very good” quality of the Option ARM  
2 portfolio, and the “very high quality” of the home equity portfolio. Defendant Killinger  
3 explicitly attributed the high credit quality of these loans to the low LTV ratios associated with  
4 those loan portfolios.

5 637. Further, Defendant Killinger underscored the Company’s “rigorous[] adher[ence]  
6 to [its] minimum FICO threshold” in its subprime portfolio. In response to a question regarding  
7 the Company’s charge-offs in its subprime portfolio, Defendant Killinger downplayed the  
8 importance of the charge-offs, explaining that the Company’s subprime portfolio had been  
9 decreasing in size and claiming that “when you’re not originating new ones at the same level and  
10 are letting the portfolio run up, you get a natural increase in [charge offs].”  
11

12 638. On or about March 1, 2007, WaMu filed with the SEC a Form 10-K for the fourth  
13 quarter and fiscal year ended December 31, 2006 (the “2006 Form 10-K”). The 2006 Form 10-K  
14 was signed by Defendants Killinger, Casey, Farrell, Woods, Frank, Montoya, Pugh, Leppert,  
15 Reed, Lillis, Smith, Matthews, Stever, Murphy, and Osmer-McQuade.  
16

17 639. In the 2006 Form 10-K, the Company reiterated the financial results set forth in  
18 the January 17, 2007, press release and earnings call. The Company also reported a full-year  
19 provision for loan and lease of \$816 million in 2006, compared with a provision of \$316 million  
20 in 2005. According to the 2006 Form 10-K, this higher provision was “substantially the result of  
21 the Company’s entry into credit card lending that resulted from the Providian acquisition and the  
22 ensuing growth in the on-balance sheet credit card portfolio, which accelerated during the fourth  
23 quarter of 2006.” The Company announced dividends declared per common share of \$2.06 and  
24 total assets of \$346.3 billion.  
25  
26  
27

1           640. In the 2006 Form 10-K, WaMu touted the Company's underwriting standards for  
2 its Option ARM portfolio, claiming that, "[t]he Company actively manages the credit risk  
3 inherent in its Option ARM portfolio primarily by ensuring compliance with its underwriting  
4 standards, monitoring loan performance and conducting risk modeling procedures." The  
5 Company went on to claim that, beginning in mid-December 2005, the Company's underwriting  
6 process for its Option ARM portfolio involved calculating the applicant's debt-to-income ratio  
7 using only the fully-indexed rate, rather than an undefined "administratively set rate" used in  
8 2004 and 2005.

10           641. In the 2006 Form 10-K, the Company announced improved credit risk  
11 management practices, stating: "In 2006, the Finance Committee of the Board of Directors  
12 approved a set of credit risk concentration limits. These limits facilitate a more rigorous and  
13 quantitative framework that better enables the credit risk management function to proactively  
14 manage credit risk."

16           642. The 2006 Form 10-K also emphasized that the Company's underwriting practices  
17 for its subprime mortgages, stating: "As part of Long Beach Mortgage's underwriting process,  
18 loan application and appraisal packages are reviewed to ensure conformity with the Company's  
19 stated credit guidelines. . . . Similarly, all purchases from Subprime Lenders must satisfy the  
20 Company's stated credit guidelines."

22           643. In its 2006 Form 10-K, WaMu also repeatedly emphasized that loan-to-value  
23 ratios were a "*key determinant of future performance*," repeating the statements made in the  
24 2005 Form 10-K related above in ¶581 above. The Company again assured investors that  
25 because credit risk was reduced when home loans had loan-to-value ratios of less than eighty  
26 percent, the Company closely monitored its home loans with loan-to-value ratios of greater than  
27

1 eighty percent. As of December 31, 2006, home loans with this increased credit risk profile  
2 amounted to \$7.48 billion and home equity loans with this increased credit risk profile amounted  
3 to \$15.5 billion of the Company's \$224.96 of loans held in portfolio. According to the  
4 Company's 2006 Form 10-K, "[s]ubstantially all of these loans were made to subprime  
5 borrowers, including \$5.56 billion of loans purchased from recognized subprime lenders. Total  
6 home loans with these features accounted for 16% of the Company's home loan volume in  
7 2006," which was an increase over the 10% of home loans with these features in 2005.

9 644. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
10 the information contained in the 2006 Form 10-K. These attestations were in substantially the  
11 form set forth in ¶562 above. Additionally, the 2006 Form 10-K contained a statement  
12 confirming the adequacy of the Company's internal controls over financial reporting in  
13 substantially the form set forth in ¶563 above.

15 645. The Company's statement in WaMu's 2006 Form 10-K that the Company  
16 "actively manage[d]" its exposure to credit risk through "ensuring compliance with its  
17 underwriting standards, monitoring loan performance and conducting risk modeling procedures"  
18 was materially false and misleading when made. The Company's claims in the 2006 Form 10-K  
19 that it underwrote its Option ARM loans to the fully-indexed rate were also false and misleading  
20 when made. Further, Defendant Killinger's statements in the earnings call that the Company's  
21 home mortgage loan and home equity loan portfolios were of "high quality" and "very high  
22 quality," respectively, were also false and misleading when made. The Company omitted from  
23 the 2006 Form 10-K the material facts that, as set forth in detail above and as reported by  
24 numerous Confidential Witnesses, starting in 2005 and continuing throughout the Class Period,  
25 the Officer Defendants had caused the Company's credit risk management to deteriorate  
26  
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1 significantly. For example, as set forth above, the Officer Defendants and the Company had  
2 repeatedly ignored both direct warnings and reports from senior WaMu risk management  
3 managers that the Company was operating outside of its supposed risk limits. Furthermore, the  
4 Company's underwriting standards, as described in detail above, were inappropriately permissive  
5 and lax. Moreover, as detailed above, starting in 2005, WaMu encouraged its employees to  
6 make exceptions to the Company's already lenient underwriting guidelines in order to maximize  
7 WaMu's loan volume. The Company's undisclosed, lenient underwriting standards had caused  
8 the Company to increase materially its loss exposure by originating loans to less qualified  
9 borrowers. Further, as detailed above, the Company's loan-volume-focused incentive structures  
10 and the culture created by WaMu's senior management, including the Officer Defendants, had  
11 caused WaMu, through its personnel, to sell and approve riskier loans without adequately  
12 considering the quality of such loans. Further, as revealed in detail above, the Company failed to  
13 disclose that WaMu secretly had pressured its appraisers, including, as discussed above, its third-  
14 party appraisers, to inflate the stated value of the homes underlying WaMu's loans, thus  
15 manipulating the LTV ratios for WaMu's mortgages and exposing the Company to much greater  
16 credit risk than was disclosed to investors.

19 646. The Company's claims in the 2006 Form 10-K that it underwrote its Option ARM  
20 loans only to the fully-indexed rate were also false and misleading when made, because, as  
21 discussed above, WaMu underwrote its Option ARM loans to the "teaser" rate well into 2007.

23 647. WaMu's claim to improved credit risk management "through a more rigorous and  
24 quantitative framework" was false and misleading when made. The Company failed to disclose  
25 the material fact that, as set forth above, the Company's risk management structure was  
26 deliberately ineffective throughout the Class Period in limiting the Company's credit loss  
27

1 exposure, as the Company had placed increased focus on loan origination volume at the expense  
2 of rigorous risk management. Moreover, as reported by numerous percipient witnesses, many of  
3 the Company's quantitative models were defective (such as the Company's LPRM, which was  
4 responsible for projecting the Company's loan losses) and those analyses that did function  
5 frequently revealed problems about the Company's loan quality and financial condition that were  
6 not disclosed to the public.

7  
8 648. The Company's reported LTV ratios in its 2006 Form 10-K and Defendant  
9 Killinger's comments at the January 30, 2007 financial services conference regarding the  
10 Company's LTV ratios during 2006 were materially false and misleading when made, because,  
11 as set forth above, the Company had been secretly inflating the appraisal values of the collateral  
12 underlying its home mortgage loans. This inflation materially understated the LTV ratios of the  
13 Company's loans.

14  
15 649. Finally, Defendant Killinger's and Casey's statements in the 2006 Form 10-K that  
16 the Company's financial results were reported in accordance with GAAP and that the Company  
17 maintained adequate internal controls were each materially false and misleading when made. As  
18 explained above, during the Class Period, the Company's internal controls over financial  
19 reporting suffered from significant deficiencies and material weaknesses because of, among  
20 other things, the Company's failure to address material deficiencies in its risk management, loss  
21 modeling methodology and other failures of internal controls (including those identified above in  
22 connection with Plaintiffs' allegations regarding WaMu's CRO Report). Moreover, rather than  
23 appropriately accounting for the Company's lax underwriting standards and inflated appraisals  
24 (thus signaling to the market how dangerously exposed the Company was to credit risk) or  
25 disclosing the known failures in its internal controls and Allowance methodology, the Officer  
26  
27

1 Defendants caused the Company to under-provision its Allowance for Loan Losses throughout  
2 the Class Period, causing the Company's net income, earnings per share, and total assets to be  
3 overstated. Furthermore, as discussed above, for year end 2006 the Officer Defendants under-  
4 provisioned the Company's loss reserves by an estimated amount of at least \$562 million, or over  
5 40%. WaMu's GAAP violations had the effect of overstating the Company's reported net  
6 income for fourth quarter 2006 by an estimated amount of at least \$110 million, or 10%, and full  
7 year 2006 by at least \$349 million, or 10%. Likewise, the Company's diluted earnings per share  
8 was overstated by an estimated amount of at least \$0.11 for the fourth quarter 2006, and \$0.35  
9 for the full year 2006.  
10

11 650. Analysts responded favorably to the Company's statements regarding the  
12 Company's credit quality. Although all analysts noted the difficult mortgage environment in  
13 which the Company operated, the Officer Defendants' reassurances that the Company had  
14 prepared for these negative events by tightening underwriting practices were well-received. For  
15 example, Erin Swanson of Morningstar observed that "all is not smooth sailing" given the  
16 "softening" in the industry; however, "[t]hat said, we think WaMu's management team  
17 anticipated this slowdown and began taking steps to position its balance sheet for tougher times.  
18 During 2006, WaMu sold all of its subprime mortgage originations, tightened its underwriting,  
19 and reduced its subprime portfolio by \$2.4 billion." Swanson raised the fair value estimate of  
20 WaMu by \$5 a share.  
21

22 651. Indeed, the Company's stock price demonstrated this favorable reaction, rising  
23 from a close of \$44.06 on January 16, 2007, to close at \$45.35 on January 24, 2007, an increase  
24 of almost 3%.  
25  
26  
27

**K. False & Misleading Statements  
Concerning First Quarter 2007 Results**

652. On April 17, 2007, WaMu issued a press release announcing its financial results for the quarter ending March 31, 2007. In this press release, WaMu reported that, for the first quarter 2007, the Company had net income of \$784 million, or \$0.86 per diluted share and total assets of \$319.9 billion. In the press release, Defendant Killinger praised the Company's performance, stating, "[o]verall, we delivered solid results in the first quarter despite the challenging interest rate environment and slowing housing market."

653. In this press release, the Company also reported that its provision for loan and lease losses was \$234 million, down from to \$344 million in the fourth quarter 2006. The Company noted that although the subprime portfolio had deteriorated, the prime portfolio had improved.

654. On that same day, the Company held an earnings call with investors to discuss the first quarter 2007 results. Defendant Killinger stressed that "While we're not at our full earnings potential, I am pleased with the solid results delivered by our team, despite a quarter that was challenged by a number of environmental factors. We had an inverted yield curve, and slowing housing markets and unprecedented deterioration in the subprime mortgage business." Further, Defendant Killinger stated, "In home loans, which felt the brunt of the environmental challenges during the quarter, we were encouraged by improved performance in our prime lending business." On the call, Defendant Killinger announced, "reflecting these results and the company's strong financial position, the Board once again increased the quarterly cash dividend, for the 47th consecutive quarter, by \$0.01, to \$0.55 cents per share."

655. Defendant Killinger stressed the positive performance of the Company's prime portfolio, claiming that the Company was "seeing encouraging signs with the improvement in the

1 prime business that we saw in the first quarter, and with the steps that we've taken into the  
2 subprime area of increasing pricing, improving underwriting, that we are starting to see that  
3 show up in the way of early signs of credit on the 2007 production looks much better than '06, so  
4 that's encouraging." Defendant Killinger went on to observe, "I would view the first quarter of  
5 having been profitable for our prime part of the business. It was offset[,] more than offset[,] by  
6 the losses in the subprime area, and as the subprime area comes back to more of a normalcy, I  
7 think that we can certainly expect the home loan unit to get back to profitability and the current  
8 expectation for us is later in the year, rather than getting specific on one quarter or the other."

10 656. Defendant Casey again highlighted the improved standards supposedly imposed  
11 on the Company's subprime channel, stating "With regard to pricing and underwriting standards  
12 in the subprime area, as Kerry mentioned, we've been working on this for quite some time.  
13 We've reduced our volume significantly and in the first quarter, we have significantly increased  
14 our pricing and *decreased our risk profile that we're willing to underwrite to*, and so we think  
15 all those factors taken together will make this business a little more profitable. *We are being*  
16 *selective with our underwriting.*" Defendant Rotella concurred, stating, "we have absolutely no  
17 plans to shut down our subprime channel. *We have, as you've heard, since the beginning of last*  
18 *year been tightening credit in that part of our business.* You heard the volume numbers were  
19 down 51% year on year and volume and we feel pretty good about the credit box we're playing  
20 in right now, but we're cautious as the market goes through this rationalization."

23 657. Also on April 17, the Company held its annual shareholders meeting in Seattle.  
24 At the shareholders meeting, Defendant Killinger continued to attribute the Company's credit  
25 problems to WaMu's to industry-wide problems, stating, "the softening housing market, a flat  
26 yield curve, aggressive credit competition, drove a rapid increase in subprime loan  
27



1 delinquencies[.]” In response to those “problems,” Defendant Killinger announced that the  
2 Company had purportedly “*tightened credit guidelines*,” and that the Company was seeing  
3 “firming” in underwriting for subprime loans. Going forward, Defendant Killinger promised  
4 investors that WaMu would “*carefully manage our credit*.” Similarly, Defendant Casey  
5 reassured investors that the Company was being “very disciplined” in growing the Company’s  
6 balance sheet and were monitoring trends in the housing market and in nonperforming assets  
7 “very closely” and would “continue to take proactive steps *to effectively manage our risks*.”  
8 Defendant Rotella also added that the Company was “tighten[ing] credit” in the subprime sector.  
9

10 658. On or about May 10, 2007, the Company filed with the SEC a Form 10-Q for the  
11 period ending March 31, 2007, which was signed by Defendants Casey and Ballenger. (the  
12 “First Quarter 2007 Form 10-Q”). The First Quarter 2007 Form 10-Q repeated the financial  
13 results set forth in the Company’s April 17, 2007 press release and earnings conference call. The  
14 First Quarter 2007 Form 10-Q also stated that “[t]he Company’s financial reporting and  
15 accounting policies conform to accounting principles generally accepted in the United States of  
16 America (‘GAAP’).”  
17

18 659. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
19 the information contained in the First Quarter 2007 Form 10-Q. These attestations were in  
20 substantially the form set forth in ¶562 above. Additionally, the First Quarter 2007 Form 10-Q  
21 contained a statement confirming the adequacy of the Company’s internal controls over financial  
22 reporting in substantially the form set forth in ¶563 above.  
23

24 660. The First Quarter 2007 Form 10-Q again reiterated the Company’s stated belief  
25 that “loan-to-value ratios are one of the two key determinants in determining future loan  
26 performance.”  
27

661. Defendants Rotella's and Casey's statements in WaMu's 2007 first quarter earnings release, during its earnings call, and during the shareholders meeting regarding the Company's actions in "tightening credit," "decreas[ing] [the Company's risk profile," and the Company's purported practice of "being selective with our underwriting" in the subprime channel since the beginning of 2006 were false and misleading when made. Further, Defendants Killinger's, Casey's, and Rotella's statements at the shareholders meeting attributing the Company's losses to only industry-wide factors were materially false and misleading when made. The Company and the Officer Defendants failed to disclose in the First Quarter 2007 Form 10-Q and during the earnings release, the earnings call and the shareholders meeting the material facts that, as set forth in detail above and as reported by numerous Confidential Witnesses, starting in 2005 and continuing throughout the Class Period, the Officer Defendants had caused the Company's credit risk management to deteriorate significantly. For example, as set forth above, the Officer Defendants and the Company had repeatedly ignored both direct warnings and reports from senior WaMu risk management managers that the Company was operating outside of its supposed risk limits. Furthermore, the Company's underwriting standards, as described in detail above, were inappropriately permissive and lax. Moreover, as detailed above, starting in 2005, WaMu encouraged its employees to make exceptions to the Company's already lenient underwriting guidelines in order to maximize WaMu's loan volume. The Company's undisclosed, lenient underwriting standards had caused the Company to increase materially its loss exposure by originating loans to less qualified borrowers. Further, as detailed above, the Company's loan-volume-focused incentive structures and the culture created by WaMu's senior management, including the Officer Defendants, had caused WaMu, through its personnel, to sell and approve riskier loans without adequately considering the quality of such

1 loans. Moreover, as revealed in detail above, the Company failed to disclose that WaMu secretly  
2 had pressured its appraisers, including, as discussed above, its third-party appraisers, to inflate  
3 the stated value of the homes underlying WaMu's loans, thus manipulating the LTV ratios for  
4 WaMu's mortgages and exposing the Company to much greater credit risk than was disclosed to  
5 investors. Also, Defendants Rotella's and Casey's statements regarding the Company's subprime  
6 operations were false and misleading because the Company failed to disclose that the cause of  
7 credit losses in the subprime portfolio was the Company's undisclosed improper underwriting  
8 practices.

10 662. Finally, Defendants Casey's and Killinger's statements in the 2007 First Quarter  
11 Form 10-Q that the Company's financial results were reported in accordance with GAAP and  
12 that the Company maintained adequate internal controls were each materially false and  
13 misleading when made. As explained above, during the Class Period, the Company's internal  
14 controls over financial reporting suffered from significant deficiencies and material weaknesses  
15 because of, among other things, the Company's failure to address material deficiencies in its risk  
16 management, loss we delivered solid results modeling methodology and other failures of internal  
17 controls (including those identified above in connection with Plaintiffs' allegations regarding  
18 WaMu's CRO Report). Moreover, rather than appropriately accounting for the Company's lax  
19 underwriting standards and inflated appraisals (thus signaling to the market how dangerously  
20 exposed the Company was to credit risk) or disclosing the known failures in its internal controls  
21 and Allowance methodology, the Officer Defendants caused the Company to under-provision its  
22 Allowance for Loan Losses throughout the Class Period, causing the Company's net income,  
23 earnings per share, and total assets to be overstated. Furthermore, as detailed above, in the first  
24 quarter 2007 WaMu under-provisioned the Company's loss reserves by an estimated amount of  
25  
26  
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1 at least \$398 million, or 63%. WaMu's GAAP violations had the effect of overstating the  
2 Company's reported net income for first quarter 2007 by an estimated amount of at least \$164  
3 million, or 21%. Likewise, the Company's diluted earnings per share was overstated by an  
4 estimated amount of at least \$0.18 for the first quarter 2007.

5  
6 663. The Company's stock price jumped at the Company earnings release, rising from  
7 a close of \$40.73 on April 16, 2007, to close at \$42.77 on April 20, 2007, an increase of 5%.

8 **L. False & Misleading Statements**  
9 **Concerning Second Quarter 2007 Results**

10 664. On July 18, 2007, WaMu issued a press release announcing its financial results for  
11 the quarter ending June 30, 2007. In this press release, WaMu reported that, for the second  
12 quarter 2007, the Company had net income of \$830 million, or \$0.92 per diluted share and total  
13 assets of \$312.2 billion. In the press release, Defendant Killinger praised the performance,  
14 stating, "We delivered record growth in our retail banking, credit card and commercials  
15 businesses during the second quarter. Our Home Loans' results improved from the first quarter  
16 and we are targeting a return to profitability by the end of the year."

17 665. In this press release, the Company also reported that its provision for loan and  
18 lease losses was \$372 million, up from \$234 million in the second quarter 2007. In the press  
19 release, the Company noted that the performance of the Company's home loans portfolio had  
20 improved over the second quarter, noting that "Home Loans shows improvement in a difficult  
21 environment," and "Prime business continues to improve."

22  
23 666. On that same day, the Company held an earnings call with investors to discuss the  
24 second quarter 2007 results. Defendant Killinger announced that "We also saw improvement in  
25 the performance of our home loans group, despite continued pressure from the challenging rate  
26 environment and ongoing weakness in the subprime mortgage market as well as continued  
27

erosion in the housing market.” Further, Defendant Casey stated, “While we anticipate that we will see higher [nonperforming assets] across all of our home loan portfolios, *we expect losses in the prime loans to be much lower due to the lower LTVs and high FICO profile of our prime portfolio.*”

667. Defendant Killinger again underscored the Company’s professed attempts to mitigate the Company’s credit risk, stating “You know it’s been over two years since we first began talking to you about housing prices becoming inflated and the high risk of a slow down in housing with price declines in some parts of the country. As a result, we started to take actions to minimize our exposure, including *tightening our underwriting*[.]”

668. Defendant Casey reiterated the quality of the Company’s provisioning for credit losses, stating

Keep in mind that the provisions is a – has been building for quite some time, we have been providing above charge-offs for the last five quarters. This is not something that immediately is reflected. We are actually looking at this over quite some time so we have been building for this. We are trying to give some perspective that we expect charge-offs to continue. But keep in mind that our provision models and our reserving model taken into account all of this information. One other thing to keep in mind is that the balance sheet did not grow this quarter, in fact loans were down, which is also contributing to that provision level. And then finally, I just point you to the allowance as a percentage of total assets in the health for investment portfolio, it actually went up from 71 basis points to 73.

669. Defendant Casey again emphasized the Company’s planning in the same call, stating, “I’m trying to give you an indication that we do factor in this deterioration of these ratios into our provisioning and reserving guidance that we have given you,” and, later:

[W]e’re trying to anticipate and project provisions well before we actually see the actual escalation like we’re seeing now. These reserve models are capturing lots of different factors. The current delinquencies and MPAs, you must keep in mind that they go 30-day delinquency and 60-[day] delinquency, we are already picking them up in our models, so that early stage delinquency information has already been picked up, and that’s why you’re seeing the reserves of those charge-offs in the previous quarters.

1 So when you actually see the higher charge-off, what you are starting to see is just  
 2 the evolution of that maturity of that delinquency rate that we're putting into our  
 3 models. And that's why we provisioned above charge-offs in the past, because the  
 4 charge-off hadn't come yet, yet we anticipated it. So there's – it's – I think it's  
 5 incorrect to be thinking that charge-offs and provisions should be linked. There's  
 6 a lot more factors that come into and it's built over a longer period of time based  
 7 on early indicators of loss as opposed to the ultimate charge-off which is  
 8 sometimes 180 days after we're seeing the early stage delinquency.

9 670. On the earnings call, Defendant Killinger touted the Company's leadership role in  
 10 the industry with regard to underwriting standards. Specifically, Defendant Killinger stated:

11 From my point of view, I think too much money, and some would say just  
 12 irrational money, did flood the mortgage market, particularly in the subprime area  
 13 over the last two years, and I think this caused underwriting standards to decline,  
 14 credit spreads to narrow, volumes to surge, and now not unexpectedly  
 15 delinquencies and losses to sore. This was a real concern of ours, and where we  
 16 took a lot of defensive *actions beginning about two years ago, like tightening*  
 17 *underwriting*, selling off our '04 and '05 residuals, delayed our plans to grow the  
 18 subprime portfolio, . . . .

19 I think now what we're seeing is, some underwriting discipline starting to return,  
 20 credit spreads are widening, and marginal players are leaving the industry. And I  
 21 think that this gives us an opportunity to gradually increase our loan portfolios,  
 22 with much improved risk adjusted returns. So I think – I do think we're watching  
 23 the subprime area very carefully. We think the industry has a lot more to go in  
 24 terms of tightening underwriting to be appropriate for today's underwriting  
 25 environment. *That's why I mentioned the initiatives that we have taken to help*  
 26 *lead the industry to what we think is much more prudent and appropriate*  
 27 *underwriting standards at this point in the cycle.* In assuming we start to see  
 28 credit quality improve because of these underwriting initiatives, and if we see  
 credit spreads widen and good opportunities to take assets in our portfolio, we  
 would like to start accelerating the – the growth of our balance sheet again.

671. On the second quarter 2007 earnings call, Defendant Casey again emphasized the  
 quality of the Company's Option ARM portfolio, stating, "There's really – we feel very good  
 about our option ARM portfolio and how it has performed. It's a very high FICO and low LTV  
 portfolio."

672. On or about August 9, 2007, the Company filed with the SEC a Form 10-Q for the  
 period ending June 30, 2007, which was signed by Defendants Casey and Ballenger (the "Second  
 Quarter 2007 Form 10-Q"). The Second Quarter 2007 Form 10-Q repeated the financial results  
 set forth in the Company's July 18, 2007 press release and earnings conference call. The Second

1 Quarter 2007 Form 10-Q also stated that “[t]he Company’s financial reporting and accounting  
2 policies conform to accounting principles generally accepted in the United States of America  
3 (‘GAAP’).”

4 673. Defendants Killinger and Casey signed certifications attesting to the accuracy of  
5 the information contained in the Second Quarter 2007 Form 10-Q. These attestations were in  
6 substantially the form set forth in ¶562 above. Additionally, the Second Quarter 2007 Form  
7 10-Q contained a statement confirming the adequacy of the Company’s internal controls over  
8 financial reporting in substantially the form set forth in ¶563 above.

10 674. Defendants Killinger’s and Casey’s statements in WaMu’s 2007 second quarter  
11 earnings call of the Company’s practice of “tightening credit,” the Company’s purported “actions  
12 to minimize [the Company’s] exposure, including tightening [the Company’s] underwriting,” and  
13 implementing “prudent and appropriate” underwriting were false and misleading when made.  
14 Further, [Defendants’] statements in the earnings call that the Company had taken a leadership  
15 role in the industry regarding tightening credit quality were false and misleading when made.  
16 The Company omitted from the Second Quarter 2007 Form 10-Q the material facts that, as set  
17 forth in detail above and as reported by numerous Confidential Witnesses, starting in 2005 and  
18 continuing throughout the Class Period, the Officer Defendants had caused the Company’s credit  
19 risk management to deteriorate significantly. For example, as set forth above, the Officer  
20 Defendants and the Company had repeatedly ignored both direct warnings and reports from  
21 senior WaMu risk management managers that the Company was operating outside of its  
22 supposed risk limits. Furthermore, the Company’s underwriting standards, as described in detail  
23 above, were inappropriately permissive and lax. Moreover, as detailed above, starting in 2005,  
24 WaMu encouraged its employees to make exceptions to the Company’s already lenient  
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27



1 underwriting guidelines in order to maximize WaMu's loan volume. The Company's  
2 undisclosed, lenient underwriting standards had caused the Company to increase materially its  
3 loss exposure by originating loans to less qualified borrowers. In addition, as detailed above, the  
4 Company's loan-volume-focused incentive structures and the culture created by WaMu's senior  
5 management, including the Officer Defendants, had caused WaMu, through its personnel, to sell  
6 and approve riskier loans without adequately considering the quality of such loans. Further, as  
7 revealed in detail above, the Company failed to disclose that WaMu secretly had pressured its  
8 appraisers, including, as discussed above, its third-party appraisers, to inflate the stated value of  
9 the homes underlying WaMu's loans, thus manipulating the LTV ratios for WaMu's mortgages  
10 and exposing the Company to much greater credit risk than was disclosed to investors.

12         675. Defendant Casey's comments in the April 17, 2007, earnings call regarding the  
13 Company's LTV ratios during second quarter 2007 were materially false and misleading when  
14 made, because as set forth above, the Company was secretly inflating the appraisal values of the  
15 collateral underlying its home mortgage loans. This inflation materially understated the reported  
16 LTV ratios of the Company's loans.

18         676. Additionally, Defendant Casey's statements regarding WaMu's purported method  
19 for determining its provision for loan and lease losses, as well as Defendants Killinger's and  
20 Casey's statements in the Second Quarter 2007 Form 10-Q that the Company's financial results  
21 were reported in accordance with GAAP and that the Company maintained adequate internal  
22 controls were each materially false and misleading when made. As explained above, during the  
23 Class Period, the Company's internal controls over financial reporting suffered from significant  
24 deficiencies and material weaknesses because of, among other things, the Company's failure to  
25 address material deficiencies in its risk management, loss modeling methodology and other  
26  
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failures of internal controls (including those identified above in connection with Plaintiffs' allegations regarding WaMu's CRO Report). Moreover, rather than appropriately accounting for the Company's lax underwriting standards and inflated appraisals (thus signaling to the market how dangerously exposed the Company was to credit risk) or disclosing the known failures in its internal controls and Allowance methodology, the Officer Defendants caused the Company to under-provision its Allowance for Loan Losses throughout the Class Period, causing the Company's net income, earnings per share, and total assets to be overstated. Furthermore, as detailed above, in the second quarter 2007 the Officer Defendants under-provisioned the Company's loss reserves by at least \$472 million, or 56%. WaMu's GAAP violation had the effect of overstating the Company's reported net income for second quarter 2007 by at least \$265 million, or 32%. Likewise, the Company's diluted earnings per share was overstated by at least \$0.30 for the second quarter 2007.

**M. Defendants' False & Misleading Statements at the  
Lehman Brothers 5th Annual Financial Services Conference**

677. On September 10, 2007, Defendants Killinger and Casey attended the Lehman Brothers 5th Annual Financial Services Conference, where Defendant Killinger continued to falsely assure investors that beginning "over two years" before, the Company had begun taking "proactive steps" to prepare for a decline in housing prices. According to Defendant Killinger, these steps included "a series of major underwriting changes in our home loans lending guidelines." Defendant Killinger also touted the Company's purportedly-low LTV ratios in its home loan portfolio and the "attractive" returns seen on Option ARM loans and other adjustable-rate mortgages, noting that "the credit quality in these loans is good."

678. Defendant Killinger went on to disclose that, while he was not updating the Company's guidance, the Company anticipated that the provision for loan losses for the full-year

2007 “could be approximately \$500 million greater” than the full year guidance the Company provided in July 2007 of \$1.5 billion to \$1.7 billion. Defendant Killinger attributed this heightened provision to a “near perfect storm” in housing conditions and rising interest rates.

679. The investing public accepted Defendant Killinger’s false assurances that the Company had taken multiple “proactive steps” to prepare for difficult housing conditions and that general conditions were to blame for the Company’s anticipated heightened provision for loan and lease losses. Indeed, on this news, WaMu’s stock price rose from a closing price of \$34.74 per share on September 10, 2007 to a closing price of \$35.56 per share on September 13, 2007, and eventually rose to close at \$38.32 per share on September 19, 2007.

680. Defendant Killinger’s statements at the Lehman Brothers Financial Services Conference were materially false and misleading in that he continued to mislead investors into thinking that the credit quality of the Company’s loan portfolio was strong. In reality, the quality of the Company’s loan portfolio was poor and the Company had not tightened its underwriting standards. Furthermore, the low LTV ratios touted by Defendant Killinger were the result of fraudulently inflated appraisal values, thus exposing the Company to massive undisclosed credit risk.

681. In addition, Defendant Killinger’s statements were materially false and misleading in that Defendant Killinger attributed the decline in the Company’s earnings and the increase in the Company’s loan loss provisions to market conditions, rather than to the Company’s improper lending and accounting practices and faulty credit risk management. As set forth above, WaMu’s underwriting standards substantially deteriorated during the Class Period which resulted in poor quality loans, increased delinquencies and non-accruals, and a massively understated loan loss provision. In truth, the anticipated increase in the Company’s loan loss

1 provision for the third quarter was driven by those undisclosed underwriting and appraisal  
2 practices, rather than, as Killinger and Casey described, “market forces.”

3 **N. False & Misleading Statements In**  
4 **The Company’s October 5, 2007 Press Release**

5 682. On October 5, 2007, the Company issued a press release entitled “Washington  
6 Mutual Q3 Net Income Impacted by Market and Credit Environments,” pre-announcing the  
7 Company’s third quarter 2007 results. In this press release, WaMu disclosed that the Company’s  
8 net income for the quarter would decline by approximately 75% from the same quarter during  
9 the prior year, and blamed this decline on “a weakening housing market and disruptions in the  
10 secondary market.” WaMu further explained that one of the primary reasons for the Company’s  
11 earnings decline was that the Company’s loan loss provision for the third quarter was expected to  
12 increase to approximately \$975 million due to “ongoing weakness in the housing market,  
13 primarily as it affects subprime and home equity loans, as well as growth in the company’s loan  
14 portfolio.”  
15

16 683. In announcing these disappointing financial results, Killinger falsely reassured  
17 investors about the Company’s financial position, explaining that WaMu was strong and well-  
18 position for improved results the following quarter. Specifically, Killinger stated: “While we’re  
19 disappointed with our anticipated third quarter results, we look forward to an improved fourth  
20 quarter as we continue to see good operating performance in our Retail Banking, Card Services  
21 and Commercial Group businesses.” Killinger also assured investors that the Company was  
22 financially stable, stating: “The company continues to have the liquidity and capital necessary to  
23 grow the company’s businesses and support its current dividend, as it continues to execute its  
24 long-term strategic plans.”  
25  
26  
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684. The investing public accepted Defendant Killinger's assurances that the Company was financially sound and that market conditions were to blame for the Company's third quarter performance. Indeed, on this news, WaMu's stock price rose from \$35.06 per share on October 5, 2007 to \$35.61 per share on October 8, 2007 and remained in the \$35 per share range for the remainder of the week.

685. WaMu's October 5, 2007 press release, and Defendant Killinger's statements therein, were materially false and misleading in that they falsely attributed the decline in the Company's earnings and the increase in the Company's loan loss provisions to market conditions, rather than undisclosed risks inherent to the Company's loan origination process. As set forth above, WaMu's underwriting standards had substantially deteriorated during the Class Period which resulted in poor quality loans, increased loan delinquencies and defaults, and a materially understated Allowance. In truth, the increase in the Company's loan loss provision for the third quarter was substantially driven by the Company's undisclosed risky and unlawful risk management, underwriting and appraisal practices detailed above, rather than merely by market forces. The October 5, 2007 press release also misrepresented the full extent of the Company's loss exposure resulting from the Company's inflated appraisal values and lenient underwriting standards and thus, misrepresented the true amount of the provision that WaMu should have recorded under GAAP.

686. Additional false and misleading statements are discussed in the Section below.

#### **IX. THE TRUTH ABOUT WAMU'S FINANCIAL CONDITION BEGINS TO EMERGE**

687. After the close of trading on October 17, 2007, less than two weeks after Killinger assured the market about the Company's financial health and outlook, WaMu disclosed that, contrary to the "improved fourth quarter" described in the October 5 press release, the Company

1 in fact expected its loan loss provision to grow to as much as **\$1.3 billion** in the fourth quarter  
2 2007. Specifically, during a conference call that day, Defendant Casey revealed that the  
3 Company's best estimate for the full year 2007 provision was "between \$2.7 and \$2.9 billion,"  
4 which Defendant Killinger explained resulted in a fourth quarter 2007 loan loss provision of  
5 "\$1.1 billion to \$1.3 billion." Moreover, in a press release issued that same day, the Company  
6 disclosed that, for the first time in 48 consecutive quarters or 12 years, WaMu was not increasing  
7 its stock dividend. Instead, that dividend would remain at \$0.56 per share, the same amount paid  
8 the prior quarter. During the conference call and in the press release, WaMu also announced that  
9 its nonperforming assets increased to \$5.5 billion, or to 1.65% of the assets held at quarter-end as  
10 compared to \$4.0 billion and 1.29% from the prior quarter. Further, the Company reported \$4.6  
11 billion in nonaccrual loans and a total Allowance of \$1.9 billion, or 41.3% of nonaccrual loans,  
12 as compared to the prior quarter when the Company reported \$3.3 billion in nonaccrual loans and  
13 a total Allowance of \$1.6 billion, or 47.6% of nonaccrual loans.

16 688. In response, numerous analysts downgraded their ratings of WaMu, citing  
17 concerns over the Company's ability to maintain its dividend and the Company's projections for  
18 an increased loan loss provision in the fourth quarter. For example, on October 18, 2007, Punk  
19 Ziegel & Company issued a report lowering its rating of WaMu from "Buy" to "Sell,"  
20 explaining: "This extreme move is being taken because [we] do not believe that the Company  
21 will be allowed to maintain its dividend and because there is no visibility as to when the  
22 company's loan loss issues will dissipate...While these numbers are troubling, of greater concern  
23 is the expectation that the loan losses in the fourth quarter will exceed those of the third quarter."  
24 Similarly, in an October 18, 2007 report, HSBC Global Research lowered its recommendation to  
25 "Neutral" from "Overweight," citing management's guidance of a "Q4 loan loss provision of  
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1 USD1.1bn to USD1.3bn,” and stating that it “is likely to go a long way toward wiping out Q4  
2 earnings. We have to admit that a 75% increase, USD1.2 bn, in the full year loan loss provision  
3 estimate from July to October is disconcerting.” Friedman, Billings, Ramsey & Co., Inc.  
4 (“FBR”) also issued a report on October 18, 2007, downgrading WaMu to “Underperform” from  
5 “Market Perform.” In doing so, FBR stated: “We believe [WaMu’s] new provision guidance,  
6 which now ranges from \$2.7B-2.9B, will result in the market beginning to factor in a dividend  
7 cut in the next few quarters, which would put downward pressure on the stock. Due to the  
8 increase in provision guidance, we are reducing our FY07 EPS estimate to \$2.35 from \$2.48 and  
9 our FY08 EPS estimate to \$2.00 from \$3.05.”

11 689. The Company’s disclosures caused WaMu’s common stock to plummet, declining  
12 almost 8% from a closing price of \$33.07 per share on October 17, 2007 to a closing price of  
13 \$30.52 per share on October 18, 2007, on heavy reported trading volume of 36,476,764 shares –  
14 more than *six times greater* than the average daily trading volume of WaMu common stock from  
15 October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before this  
16 first partial disclosure). The price of WaMu stock continued to trend downward, declining  
17 another almost 5% to close at \$29.09 per share on October 19, 2007, on significant reported  
18 trading volume of 31,543,300 shares. This disclosure resulted in a two day market capitalization  
19 loss of nearly **\$4 billion**.

21 690. Defendants prevented an even steeper decline, however, by falsely blaming the  
22 Company’s performance on “weakening in the housing market” and “capital markets disruption”  
23 and assuring investors that the Company was financially strong with “appropriate capital and  
24 sources of liquidity.” Accordingly, the complete truth about the Company’s improper lending,  
25 accounting and credit risk management practices was not revealed to investors. Defendants  
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1 further mitigated the impact of WaMu's October 17 disclosures by falsely minimizing the full  
2 extent of the Company's loss exposure resulting from the Company's lending practices and  
3 therefore, misrepresenting the amount of the provision that WaMu was required to record under  
4 GAAP. As set forth above, this increased provision was grossly insufficient, both in terms of  
5 adequately provisioning for the third quarter 2007 as well as in redressing the cumulative  
6 understatement of the Company's Allowance throughout the Class Period. Accordingly, the  
7 Company's October 17 press release and earnings call were materially false and misleading, and  
8 only partially disclosed the Company's true condition.

10 691. Only two weeks after the Company successfully concealed the truth about its  
11 lending practices by blaming its performance on secondary market disruption – investors were  
12 shocked by revelations about WaMu's improper manipulation of appraisal values. Specifically,  
13 on November 1, 2007, New York Attorney General Cuomo filed a lawsuit against First American  
14 and its subsidiary eAppraiseIT alleging that Washington Mutual pressured these companies into  
15 fraudulently inflating the appraisals used in Washington Mutual's loan origination process  
16 (defined above as the "NYAG Complaint"). Eric Corngold, New York's Deputy Attorney  
17 General for Economic Justice explained the allegations in the NYAG Complaint as follows:  
18 "Simply put, First American and eAppraiseIT signed over their independence to Washington  
19 Mutual, so that *Washington Mutual's loan staff could illegally hand-pick the appraisers who*  
20 *would hit the numbers that Washington Mutual wanted.*"

23 692. In response to these allegations, the price of WaMu stock dropped \$2.13 per  
24 share, or almost 8%, from a closing price of \$27.88 per share on October 31, 2007 to a closing  
25 price of \$25.75 per share on November 1, 2007, on heavy reported trading volume of 33,179,008  
26 shares – *5.7 times greater* than the average daily trading volume of WaMu common stock from  
27

1 October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the  
2 Company's first partial disclosure).

3 693. The Company attempted to mitigate the impact of the disclosures contained in the  
4 NYAG Complaint by issuing a broad-based denial, falsely asserting that it did not have any  
5 motivation to manipulate appraisal values. Specifically, in a press release issued on November 1,  
6 the Company stated: "We have absolutely no incentive to have appraisers inflate home values.  
7 In fact, inflated appraisals are contrary to our interests. We use third-party appraisal companies  
8 to make sure that appraisals are objective and accurate." The Company also announced that it  
9 was suspending its relationship with eAppraiseIT until it had time to further investigate the  
10 situation.  
11

12 694. Notwithstanding the Company's denials, the Company's stock price continued to  
13 decline as analysts sought to quantify the severity of the allegations in the NYAG Complaint.  
14 For example, on November 2, 2007, *Market Watch* published an article quoting Frederick  
15 Cannon, an analyst with Keefe Bruyette & Woods. In this article, Cannon questioned WaMu's  
16 assertion that it had no incentive to inflate the appraised value of homes that it lends against and  
17 stated that the NYAG Complaint "could create big problems" and "raises an issue of  
18 considerable risk to Washington Mutual." Cannon further stated that, "[i]n a worst-case scenario  
19 – in which inflated appraisals were systemic throughout WaMu – the lender might need to set  
20 aside an extra \$2.1 billion, or \$1.57 per share, of reserves." Among other things, this analysis  
21 underscores the enormous significance (and obvious materiality) of WaMu's practice of inflating  
22 appraisals to its financial condition. Moreover, on this same day, WaMu's regulatory agency,  
23 OTS, disclosed that it was "actively looking into" the allegations of appraisal manipulation at  
24 WaMu. On this news, WaMu's stock price dropped \$1.94 per share, or 7.5%, to close at \$23.81  
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per share on November 2, 2007, on significant reported trading volume of 31,041,898 shares – more than *five times greater* than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).. Moreover, this disclosure of WaMu’s appraisal manipulations caused WaMu’s stock price to drop to its lowest closing price since September 2000 and resulted in a two day market capitalization loss of more than **\$3 billion**.

695. On November 7, 2007, Attorney General Cuomo broadened his attack on the Company by announcing the expansion of his investigation into WaMu’s fraudulent appraisal practices to include an examination of the loans that WaMu sold to Fannie Mae and Freddie Mac, the nation’s two biggest providers of mortgage financing. Specifically, Attorney General Cuomo stated:

The integrity of our mortgage system depends on independent appraisers. ***Washington Mutual compromised the fairness of this system by illegally pressuring appraisers to provide inflated values.*** Every company that buys loans from Washington Mutual must be sure that the loans they purchased are not corrupted by this ***systemic fraud***.

Attorney General Cuomo further disclosed that his office had subpoenaed Fannie Mae and Freddie Mac, seeking information on the mortgage loans that Fannie Mae and Freddie Mac had purchased from WaMu, among other banks, and that Fannie Mae and Freddie Mac agreed to his demand that they “retain an Independent Examiner, subject to the Attorney General’s approval, to conduct a total review of all Washington Mutual . . . appraisals and mortgages purchased by the companies.”

696. That same day, WaMu announced that the Company’s loan loss provision could exceed \$1.3 billion in the first quarter 2008. Specifically, at WaMu’s 2007 Annual Investor Day Conference, in which Defendants Killinger, Cathcart, Schneider, Casey and Rotella all participated, the Company disclosed that it expected the “first quarter 2008 provision to be

1 similar or slightly higher than” the \$1.1 billion to \$1.3 billion range of the Company’s fourth  
2 quarter 2007 loan loss provision. The Company also revealed that nonperforming assets and  
3 charge-offs in the Company’s single family residential portfolio increased and that “roll rates into  
4 60 and 90 day delinquencies are much higher, as fewer borrowers the ability to refinance or  
5 quick sale their way out of trouble.”

6  
7 697. These revelations by Attorney General Cuomo and the Company caused WaMu  
8 stock to drop *more than 17%*, to close at \$20.04 on November 7, resulting in a single day market  
9 capitalization loss of *more than \$3.5 billion*. Moreover, the reported trading volume on this  
10 news was unusually heavy, involving 68,642,699 shares – almost *twelve times greater* than the  
11 average trading volume of WaMu common stock from October 19, 2005 (the first day of the  
12 Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

13  
14 698. Defendants again succeeded, however, in mitigating the impact of these  
15 disclosures by falsely blaming the “downturn of the housing market and capital market  
16 disruptions” for the Company’s financial performance while assuring investors of the Company’s  
17 stability and the “stronger credit quality” of the Company’s single family residential portfolio.  
18 Defendants continued to deny any manipulation of appraisal values for loans originated by  
19 WaMu.

20  
21 699. For example, speaking at the Investor Day Conference, Defendant Killinger  
22 emphasized that “[t]he key point here is that since the [single family residential] portfolio has  
23 stronger credit quality and lower LTVs, we expect these nonperforming loans will lead to  
24 significantly lower net charge offs than the subprime mortgage channel and home equity  
25 portfolios.” Killinger also added that “our risk is contained [and] our underwriting is sound.”  
26 Similarly, Defendant Schneider pointed out that, because of the Company’s “prudent  
27

1 underwriting standards as well as tighter guidelines for markets where we have concerns about  
2 house prices,” the Company had “a 17 percentage point reduction in loans with LTVs higher than  
3 80.” WaMu also defended its appraisal practices and claimed, at the conference as well as in a  
4 press release issued that same day, that the appraisals performed by eAppraiseIT were subject to  
5 strict quality control programs, were required to be “prepared in compliance with the Uniform  
6 Standards of Professional Appraisal Practice” and were required to be “prepared without fraud or  
7 negligence.” These misstatements and false denials succeeded in concealing from investors the  
8 full extent of the Company’s loss exposure arising from WaMu’s undisclosed and improper  
9 lending practices and deficient risk management.  
10

11         700. Nonetheless, analysts lowered their earnings estimates citing the Company’s  
12 uncertain legal and financial situation. For example, in a November 7 report titled “Cutting  
13 Estimates on More Uncertain Outlook,” Fox-Pitt Kelton Cochran Caronia Waller (“Fox-Pitt”) stated:  
14 “WM’s investor day highlighted the uncertainties facing the company on a variety of  
15 fronts – credit, margin, market improvement and legal/regulatory.” Similarly, in a November 7  
16 report, Bear Stearns lowered its 2008 EPS estimates for WaMu, noting: “We also believe that  
17 today’s statements by New York Attorney General Andrew Cuomo that Fannie Mae and Freddie  
18 Mac have agreed to hire examiners to look through loans they purchased from WaMu for  
19 potentially inflated or otherwise fraudulent appraisals signals an increased level of legal and  
20 regulatory risk for WaMu.”  
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23         701. Analysts continued to voice concern over WaMu’s uncertain legal and financial  
24 predicament on November 8, 2007. For instance, on this date, Merrill Lynch issued a report,  
25 observing that “[a]nother shoe drops on WM” and stating: “Concern over rising cyclical credit  
26 costs is being compounded by recent news alleging WM of participating in or being victim of  
27

1 appraisal fraud. If true, the potential for further losses would add significant risk to the earnings  
2 outlook for WaMu and possibly its capital adequacy. The crux of the problem is quite simple and  
3 possibly pervasive.” Regarding the effect of inflated appraisals on the Company’s balance sheet,  
4 Merrill Lynch commented, “[r]ough estimates suggest that WM could witness after-tax losses of  
5 \$1.05-\$1.70 [per share], possibly as high as \$3.80 in a worse case scenario, resulting from the  
6 possible forced repurchase of loans underwritten with faulty appraisals.” The report explained,  
7 “*[l]osses on loans with fraudulent appraisals would likely be higher than normal, given the*  
8 *defective nature of the loan.* Assuming most appraisal fraud events would likely arise in weak  
9 housing markets, the related incidence of loss would likely be higher as well.” Merrill Lynch  
10 further added: “This injects significant uncertainty into the WM story, one which could  
11 potentially have meaningful downside to both WaMu’s earnings and reputation, in our view.”  
12 Bear Stearns also issued a report on November 8, 2007, stating: “We found WaMu’s disclosure of  
13 the increases in ‘roll rates,’ or the percentage of borrowers who move from one month delinquent  
14 to two and three months delinquent, rather alarming.” Significantly, even though Bear Stearns  
15 found the Company’s increased delinquency rates to be concerning, this increase was the  
16 materialization of the Company’s undisclosed and improper lending practices. Indeed, as set  
17 forth above, the Company’s fraudulent appraisal and underwriting practices resulted in the  
18 Company originating an ever-increasing number of loans to buyers who were not able to repay  
19 their loans and became delinquent in their payments to WaMu, causing the Company’s  
20 delinquency rates to increase and the quality of WaMu’s loan portfolio to become increasingly  
21 weaker.  
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25 702. This analysis of the news release on November 7 caused WaMu’s stock price to  
26 decline another 3%, dropping from a close of \$20.04 per share on November 7 to close at \$19.39  
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per share on November 8, on heavy reported trading volume of 55,602,134 shares – ***11.8 times greater*** than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

703. On November 9, 2007, the Company filed with the SEC a Form 10-Q for the quarter ended September 30, 2007 (the “Third Quarter 2007 Form 10-Q”), which was signed by Defendants Casey and Ballenger and included certifications by Defendants Killinger and Casey. The Third Quarter 2007 Form 10-Q repeated the financial results set forth in the Company’s October 17, 2007 press release, including that the Company’s provision for loan and lease losses was \$967 million for the quarter and that the Company was not increasing its quarterly dividend. The Third Quarter 2007 Form 10-Q continued to conceal the Company’s improper lending, and accounting practices and deficient risk management. It also failed to disclose the true extent of the Company’s loss exposure.

704. On November 21, 2007, Moody’s Investors Service downgraded the ratings of 34 tranches on seven Alt-A deals issued by WaMu in 2006 and late 2005, and placed under review for possible downgrade another 8 tranches from these same deals. Moody’s negative rating actions were taken because of higher than anticipated rates of delinquency, foreclosure and real estate owned (“REO”) property in the underlying collateral relative to credit levels. Like delinquencies and foreclosures, REO properties are problematic for lenders – and raise concern for investors and analysts – because they are properties owned by a lender, such as WaMu, after an unsuccessful sale at a foreclosure auction, which typically happens when the property up for sale at the auction is worth less than the total amount owned to the bank. On this news, WaMu’s stock fell almost 4%, from a closing price of \$17.99 per share on November 20, 2007 to a

1 closing price of \$17.34 per share on November 21, 2007, on reported trading volume of  
2 23,448,628 shares – more than *four times greater* than the average daily trading volume of  
3 WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16,  
4 2007 (the day before the Company’s first partial disclosure).

5  
6 705. On December 10, 2007, after the close of market, WaMu issued a press release  
7 that once again contradicted its prior assurances to investors. Specifically, the Company  
8 announced that it was slashing its quarterly dividend from \$0.56 per share to just \$0.15 per share  
9 and increasing its loan loss provision guidance for the fourth quarter 2007 and first quarter of  
10 2008. The Company also announced a major “resizing” of its homes loans business and a \$2.5  
11 billion offering of convertible preferred stock, and that it would take a \$1.6 billion after-tax  
12 charge against goodwill associated with its home loans business during the fourth quarter 2007.

13  
14 706. With respect to its increased loan loss provision guidance, the Company disclosed  
15 that it expected its fourth quarter 2007 provision to be \$1.5 to \$1.6 billion, more than 25% higher  
16 than the \$1.1 to \$1.3 billion guidance the Company had given one month earlier. The Company  
17 also announced that it expected that its first quarter 2008 loan loss provision would be “in the  
18 range of \$1.8 to \$2.0 billion” and that its loan loss provision for each quarter of 2008 would be  
19 similar, if not higher, than the expected first quarter 2008 provision. The Company was therefore  
20 projecting a full year 2008 loan loss provision of approximately \$7.2 to \$8.0 billion, more than  
21 double the estimated \$3.1 to \$3.2 billion loan loss provision it expected to record for 2007, and  
22 almost *ten times* the \$816 million loan loss provision the Company recorded for 2006.

23  
24 707. In terms of its “resizing” of its home loans business, the Company disclosed that  
25 it planned to make the following adjustments:

- 26  
27
  - Discontinue any remaining lending through its subprime mortgage channel;

- Close approximately 190 of its 336 home loan centers and sales offices;
- Close nine of its Home Loan processing and call centers;
- Eliminate approximately 2,600 of its Home Loans positions, or about 22% of its Home Loans staff;
- Eliminate approximately 550 corporate and other support positions; and
- Close WaMu Capital Corp., its institutional broker-dealer business, as well as its mortgage banker finance warehouse lending operation.

The actions taken in connection with the Company's "resizing" highlight the substantial and material impact that the Company's improper lending practices had on the Company's financial and operational condition. As a result of the Company's enormous (and not fully disclosed) loss exposure due to the Company's fraudulent lending practices and deficient risk management efforts, WaMu was forced virtually to shut down its home lending business. By taking such drastic measures – which included closing its subprime business, closing almost 60% of its home loan and sales offices, terminating more than 3,000 employees and closing its mortgage warehouse lending operation – WaMu was implicitly acknowledging that the growth and profitability that the Company had experienced in its lending operations were dependant, at least in part, on the Company's fraudulent lending practices, including the issuance of high-risk loans to unqualified borrowers and the manipulation of appraisals.

708. In response to these disclosures, the Company's stock fell over \$2.46 per share, or more than 12%, from a close of \$19.88 per share on December 10 to close at \$17.42 per share on December 11, on enormous reported trading volume of 152,826, 497 shares – more than **26 times greater** than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company's first partial disclosure).



1           709. In addition, the Company's December 10 announcements further unnerved  
2 analysts who raised more questions and concern over the Company's earnings prospects and loss  
3 exposure. For instance, that same day Moody's cut WaMu's rating two notches to Baa2, the  
4 second lowest investment grade, from A3, questioning whether WaMu could return to  
5 profitability before 2010 and noting "its view that credit losses from WaMu's mortgage  
6 operations will be noticeably higher than previously estimated." Also on December 10, Fitch  
7 Ratings downgraded WaMu to "A-" from "A" citing "worsening asset quality." Citigroup Global  
8 Markets issued a report on December 11, cutting its 2007, 2008 and 2009 earnings estimates for  
9 WaMu and noting that: "While we expected some of these measures would be needed, the  
10 magnitudes are generally worse." Similarly, D.A. Davidson & Co. issued a report on December  
11 11, noting that: "On the surprise front: WM once more guided credit costs higher" and that the  
12 Company's latest disclosure "essentially wipes out EPS for both" 2007 and 2008.  
13

14  
15           710. A December 11 report issued by Morgan Stanley Research also lowered the  
16 Company's earnings outlook, stating that: "WaMu's moves to strengthen capital and reserves  
17 strikes us as a positive, although the magnitude of the new loss guidance for 2008 is  
18 disconcerting." Stifel Nicolaus also issued a report on December 11, revising its earnings  
19 projections downward and stating that: "We were not surprised WaMu cut the dividend and  
20 announced a capital raise...The magnitude of the cut, however, was somewhat more than we had  
21 expected." The Stifel Nicolaus report further added:  
22

23           That WaMu would have to increase provisions was also not  
24 surprising. What was unclear was the timing, and one big question  
25 remaining is just how much pain is WaMu pulling forward with its  
26 projected ~\$3.5B provision in the next two quarters? We believe  
27 the answer is 'Not all of it.' We estimate lifetime losses remaining  
on the current mortgage portfolio at ~\$7.7B, suggesting the higher  
4Q07 and 1Q08 provisions are a good start, but not the end of the  
pain.



1           711. Moreover, some analysts began to speculate that, contrary to the Company's  
2 repeated statements, WaMu's increasing losses might be the result of poor underwriting by the  
3 Company. Specifically, Fox-Pitt issued a report on December 11, 2007, downgrading the  
4 Company to "In Line from Outperform." In doing so, the report stated that "the size of  
5 [WaMu]'s expected credit losses is now far larger than we had expected" and noted that WaMu  
6 could also be "suffering from poor underwriting quality."

7  
8           712. Similarly, in a report issued that same day, Morgan Stanley questioned the  
9 Company's evaluation of its credit risk, because "the rapid deterioration in the housing  
10 environment and *questions about WaMu's loan products, geographic concentration, and*  
11 *underwriting make it difficult to bracket the downside.*" Further, the NYAG Complaint  
12 continued to resonate as a danger to WaMu's future financial prospects, as noted in a December  
13 11 Citigroup Global Markets report issued that same day, which changed its rating from Hold to  
14 Sell "based on the rapid increase in provisioning which dampens future growth prospects as well  
15 as future increased uncertainty with regard to the NY attorney general's appraisal inquiry."

16  
17           713. Other analysts noted the Company's dangerous concentrations in risky loan  
18 products, such as a Credit Suisse report issued on December 14 that observed, "Higher than  
19 expected losses are driven by deterioration in its subprime, home equity, option ARM and credit  
20 card portfolios." As a result of these disclosures, analysts began to voice concerns over WaMu's  
21 credibility, as the Credit Suisse report commented: "As a result of numerous upward revisions to  
22 management's credit expectations in the past couple of months, we believe management's  
23 credibility is questionable."

24  
25           714. As analysts continued to report on the Company's December 10 disclosure over  
26 the following days, WaMu's stock price dropped even lower, falling to a low of \$15.59 per share  
27

1 by December 13, 2007, for a total drop of more than 22%, resulting in a three day market  
2 capitalization loss of approximately **\$3.7 billion**.

3 715. Notwithstanding the partial disclosure of the Company's true condition, the  
4 Company's December 10 press release was a materially false and misleading statement because  
5 it continued to conceal the Company's improper lending practices and the full extent of the loss  
6 exposure confronting the Company. In fact, the Company's true loan loss provision was far  
7 more significant than the Company was willing to disclose at that point.  
8

9 716. On December 21, 2007, before the open of the market, *The Wall Street Journal*  
10 reported that the SEC had launched an inquiry into the Company's mortgage lending practices.  
11 According to *The Wall Street Journal*, the SEC was focused on whether "the company properly  
12 accounted for its loans in financial disclosures to investors of the company." WaMu confirmed  
13 the SEC's inquiry, but once again attempted to diminish the impact of this revelation by issuing a  
14 statement denying any wrongdoing: "After spending a month and a half investigating these  
15 allegations, we can say with confidence that there has been no systematic effort by WaMu to  
16 inflate home appraisals." Despite the Company's mitigation efforts, following this news, shares  
17 of WaMu stock dropped as low as \$13.76 per share in mid-day trading on December 21, 2007,  
18 and closed at \$14.10 per share, on significant reported trading volume of 39,575,807 shares.  
19 News of the SEC's inquiry resulted in a one day decline of almost 4% and topping off a 28%  
20 drop in price since the beginning of the month.  
21  
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23 717. On January 17, Gradient Analytics ("Gradient") issued a report, analyzing  
24 impairment risk at fifteen publicly traded lenders, including Washington Mutual. In this report,  
25 Gradient stated that, as a result of its analysis, it continued to believe that WaMu was "the most  
26 at-risk firm among large capitalization lenders." Gradient further reported that: "in our  
27

1 estimation, WaMu's prior loan loss provisions have been insufficient to establish a reserve that  
2 fully accounts for the level of nonperforming loans" and that if WaMu "were to establish a  
3 reserve that reflects the likelihood that nonperforming loans will continue to increase for at least  
4 the next year," WaMu could have to record an impairment charge of "as much as \$15.3 billion."

5  
6 718. In response to this disclosure, the Company's stock fell 7%, from a closing price  
7 of \$13.39 per share on January 16, 2008 to closing price of \$12.46 per share on January 17,  
8 2008, on significant reported trading volume of 47,279,787 shares.

9 719. After the close of the market on January 17, 2008, the Company announced its  
10 first annual loss since 1994 and its first quarterly loss since 1997. Specifically, the Company  
11 issued a press release that evening reporting its earnings for the quarter and year ended  
12 December 31, 2007, which included a net loss of \$1.87 billion, or \$2.19 per share, for the fourth  
13 quarter 2007, and a net loss of \$67 million, or \$0.12, for the full year 2007. The press release  
14 also confirmed the Company's prior announcement of a paltry dividend of \$0.15 per share and  
15 that the Company's loan loss provision for the quarter was \$1.53 billion, within the \$1.5 to \$1.6  
16 billion guidance provided by management in December. The Company also announced that its  
17 allowance was \$2.57 billion at year end.  
18

19 720. That same evening, the Company held a conference call to discuss its fourth  
20 quarter and year end 2007 financial results. Defendants Killinger, Casey and Rotella participated  
21 in the call. In discussing the Company's financial results, these defendants again blamed the  
22 Company's financial performance on the "turmoil" and "unprecedented challenges in the  
23 mortgage and credit markets," and not the Company's improper lending, and accounting  
24 practices and deficient risk management. Indeed, the Company's January 17 disclosures, which  
25 only partially revealed the Company's true financial condition, continued to conceal the full  
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1 magnitude of the Company's loss exposure and the full size of the Company's loan loss  
2 provision that was yet to be recorded.

3 721. Analysts responded to WaMu's earnings release cautiously, somewhat relieved  
4 that the financial results were consistent with the Company's recent guidance, but still concerned  
5 about the Company's remaining loss exposure. For example, on January 17, 2008, Fox-Pitt  
6 issued a report titled, "A Sigh Of Relief" which, while cutting 2008 earnings estimates to a loss  
7 of \$1.49 per share from \$1.19 per share, positively noted that "management did not change its  
8 estimate of provision costs for '08" and "we are comfortable that '08 will represent the peak in  
9 credit provision costs." Similarly, Credit Suisse issued an analyst report on January 17, lowering  
10 its 2008 earnings per share estimate and noting that "[w]e remain cautious on WaMu shares."  
11 Credit Suisse also stated that: "Credit quality deterioration exhibited few signs of abating in Q4  
12 with [nonperforming assets] up 30% sequentially and 154% year over year. This was well above  
13 our expectations."  
14

15  
16 722. Similarly, on January 18, 2008, Citigroup Global Markets issued a report,  
17 lowering its earnings estimates for 2008 and 2009, and noting: "We remain cautious on WM's  
18 shares during this period of elevated credit cost & business uncertainty." Citigroup further stated  
19 that: "We think WM has effectively boxed its mortgage and credit market related risk exposure,  
20 helping contain potential future charges and loss levels. Nevertheless, its exposures remain  
21 sizeable and will likely continue to dampen earnings and profitability." In noting that WaMu's  
22 shares were trading below tangible book value, a Punk Ziegel & Company report issued on  
23 January 22 observed, "The stock sells where it does because most investors feel confident that  
24 the company will be forced to take additional significant write-offs against its holdings of sub-  
25 prime and negative amortization loans." Similarly, a report by Merrill Lynch, issued on January  
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23, stated that, “the credit problems inherent in [WaMu’s] . . . balance sheet[] are likely to forestall a near-term recovery or acquisition.”

723. On February 29, 2008, the Company filed with the SEC its Form 10-K for the year ended December 31, 2007, which was signed by, among others, Defendants Killinger, Casey and Ballenger and included certifications by Defendants Killinger and Casey. On May 22, 2008, the Company filed with the SEC its Form 10-K/A for the year ended December 31, 2007 (together, these filings are collectively referred to as the “2007 Form 10-K”). The 2007 Form 10-K repeated the financial results set forth in the Company’s January 17 press release. Most significantly, the 2007 Form 10-K continued to conceal the Company’s improper lending, and accounting practices and deficient risk management practices as well as the true extent of the Company’s loss exposure.

724. On March 3, 2008, Fitch Ratings downgraded \$2.3 billion worth of WaMu mortgage pass-through certificates backed by first lien subprime mortgages originated by WaMu. Fitch based its downgrade on “the deteriorating performance of [WaMu’s mortgage] pools from 2007, 2006 and late 2005 with regard to continued poor loan performance and home price weakness.” On this news, WaMu’s stock price fell \$1.15, or more than 7.7%, from an opening price of \$14.80 per share on March 3 to a closing price of \$13.65 per share on March 3, on substantial reported trading volume of 48,349,043 shares – more than *eight times greater* than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

725. On March 6, 2008, Standard & Poor’s downgraded the Company’s long-term credit rating to “BBB” from “BBB+” because of credit concerns. Similarly, Dominion Bond

Rating Service Limited (“DBRS”) downgraded all long-term debt ratings of WaMu and its subsidiaries to BBB (high) from A (low) citing concerns that “credit losses in the Company’s residential mortgage portfolio will continue to increase at an accelerated pace given the fact that WaMu’s portfolio has significant exposure to high loan-to-value second mortgages and to the regions that have experienced the most significant depreciation in house prices (such as California and Florida).” At the same time, DBRS also lowered its short-term debt ratings of WaMu from R-2 (high) to R-1 (low). In lowering the Company’s debt ratings, DBRS noted that the “trend on all ratings remains Negative.” Following this news, the Company’s stock price plunged 8% from a closing price of \$12.80 per share on March 5, 2008 to a closing price of \$11.76 per share on March 6, 2008, on significant reported trading volume of 53,366,618 shares – more than **nine times greater** than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s partial disclosure)

726. On March 7, 2008, *The Wall Street Journal* reported that WaMu was approaching private-equity funds, sovereign-wealth funds, and other investors about possible cash infusions. On that same day, Merrill Lynch stated in a report that it expected the Company to report losses of as much as \$11.2 billion through 2009 as more borrowers defaulted on home loans. On this news, the Company’s stock price fell another 9%, dropping to a close of \$10.71 per share on March 7, on massive reported trading volume of 110,506,154 shares – almost **nineteen times greater** than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure)

727. After the close of the market on March 7, 2008, Fitch Ratings lowered its ratings on the Company citing “a variety of internal and external sources” who predicted that WaMu’s first quarter 2008 earnings, along with earnings of other United States banks, will show “rapid deterioration” in its home equity loans portfolio. In addition, Fitch pointed out that “[a]pproximately 37% of WM’s total loan portfolio comprises residential mortgage and home equity loans in California,” a state where properties “appear to be deteriorating at a faster pace than those in more stable markets.” WaMu’s stock price fell more than 6% on this news to close at \$10.04 per share on March 10, on reported trading volume of 73,738,572 shares –**12.6 times greater** than the average daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

728. On March 14, 2008, WaMu’s stock price dropped almost 13%, on significant reported trading volume of 84,670,239 shares, after Moody’s downgraded the Company’s senior unsecured debt rating from Baa2 to Baa3, one level above junk status. In lowering its rating, Moody’s explained that it “believes that remaining lifetime losses on [WaMu’s residential mortgage loan] portfolio will be higher than previously expected” and that “WaMu’s required provisioning is likely to be greater than \$12 billion and that full year 2008 net losses could eliminate the company’s approximately \$6 billion capital cushion above regulatory well capitalized minimums.” Moody’s also placed a negative outlook on all WaMu entities.

729. On March 17, 2008, WaMu’s stock price fell further as investors continued to respond to Moody’s March 14 downgrade and became concerned about the Company not having any viable buyout prospects in the wake of JP Morgan Chase & Co.’s purchase of Bear Stearns Cos. Indeed, as reported by *Bloomberg News* on March 17, before the open of the market,



1 “shares of Washington Mutual are dropping in premarket trading, as the sale of Bear Stearns Cos.  
2 and a downgrade from Moody’s Investors Service pressure the savings and loan stock.” Later  
3 that day, *Bloomberg News* further reported that WaMu “fell to its lowest since 1995 on waning  
4 prospects for takeover” as JP Morgan’s “\$240 million purchase of Bear Stearns Cos. removed  
5 one of the largest potential buyers from the market.” As a result of this news, WaMu’s stock  
6 price dropped almost 13%, falling from a close of \$10.59 per share on March 14 to close at \$9.24  
7 per share on March 17. This disclosure also sparked massive reported trading volume, involving  
8 more than 109,266,368 shares – **18.7 times greater** than the average daily trading volume of  
9 WaMu common stock from October 19, 2005 (the first day of the Class Period) until October 16,  
10 2007 (the day before the Company’s first partial disclosure).

12 730. On March 27, 2008, Lehman Brothers issued a report setting forth revised  
13 estimates for the Company’s 2008 financial results, including an earnings loss of \$2.84 per share  
14 and a loan loss provision increase to \$10 billion. The report also estimated that the Company  
15 would need to set aside \$5 billion in 2009 for loan losses, and would incur \$6 billion in charge-  
16 offs in 2008 and \$7 billion in charge-offs in 2009. On this news, WaMu’s stock price dropped  
17 more than 8% on reported trading volume of 44,246,517 shares – **7.6 times greater** than the  
18 average daily trading volume of WaMu common stock from October 19, 2005 (the first day of  
19 the Class Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

21 731. Thereafter, on April 4, 2008, Keefe Bruyette & Woods issued a report doubling its  
22 2008 estimated loss for WaMu to \$3.15 per share from \$1.45 per share. This report also noted  
23 that, mortgage and other credit losses may keep WaMu from turning an annual profit before  
24 2010. Following these downward earnings revisions, WaMu stock fell 12%, to close at \$10.17  
25 per share on April 4, on significant reported trading volume of 67,901,502 shares – **11.6 times**  
26  
27



1 **greater** than the average daily trading volume of WaMu common stock from October 19, 2005  
2 (the first day of the Class Period) until October 16, 2007 (the day before the Company's first  
3 partial disclosure).

4 732. On April 7, 2008, reports circulated that a group led by private equity firm TPG  
5 was close to a deal to invest \$5 billion in WaMu, an investment that was viewed as necessary in  
6 order for WaMu's to alleviate its pressing capital requirements. After the close of the market on  
7 April 7, additional reports circulated, stating that, in connection with this deal, WaMu was  
8 exiting its wholesale lending business.

10 733. On April 8, 2008, the Company announced its disappointing first quarter 2008  
11 results, including that the Company suffered a net loss of \$1.1 billion, or \$1.40 per share, and  
12 that the quarterly dividend was reduced from \$0.15 to \$0.01. The Company also disclosed that  
13 the loan loss provision increased to \$3.5 billion, almost double what the Company stated it  
14 would be on December 10, 2007. On this same day, the Company also stated that it was closing  
15 all 186 of its stand-alone home loan offices nationwide and eliminating approximately 3,000 jobs  
16 as part of the closings. The Company also officially announced that it would raise \$7 billion in  
17 capital through a direct sale of equity securities to an investment vehicle managed by TPG  
18 Capital. While this news provided additional insight into the Company's financial condition, it  
19 nonetheless continued to understate the size of the Company's loss exposure and the reasons why  
20 the Company was in this precarious financial position, including its need to accept \$7 billion in a  
21 deal that was described by *The Wall Street Journal* as "punitive" as it could result in the  
22 Company nearly doubling its shares outstanding, a massive dilution for existing shareholders.

25 734. On this news, the WaMu's stock price dropped 10%, to close at \$11.81 per share  
26 on April 8, 2008, on massive reported trading volume of 180,896,539 shares – more than 32  
27



1           736. Similarly on April 11, 2008, Goldman Sachs issued a report, recommending that  
2 its clients short-sell WaMu stock because it estimated that WaMu has “\$17 to \$23 billion of  
3 embedded losses in its current book of business” and forecasted “a “\$14b provision charge in  
4 2008.” Goldman Sachs further estimated that WaMu may lose \$3.30 per share in 2008. On this  
5 news, WaMu’s stock fell more than 4%, from a closing price of \$11.42 per share on April 10 to a  
6 closing price of \$10.95 per share on April 11, on heavy reported trading of 55,243,132 shares –  
7 more than **9 times greater** than the average daily trading volume of WaMu common stock from  
8 October 19, 2005 (the first day of the Class Period) until October 16, 2007 (the day before the  
9 Company’s first partial disclosure).  
10

11           737. In a report issued on April 16, 2008, Chris Brendler of Stifel Nicolaus questioned  
12 the Company’s ability to return to profitability, observing, “as [management] struggles to right  
13 the sinking ship, we are increasingly questioning the value of [WaMu]’s remaining franchise.  
14 ***The home loan business is broken, the loan portfolio is a disaster. . . .***”  
15

16           738. On April 29, 2008, WaMu announced that Defendant Cathcart left the Company.

17           739. On May 12, 2008, WaMu the filed with the SEC its Form 10-Q for the quarter  
18 ended March 31, 2008 (the “First Quarter 2008 Form 10-Q”), which was signed by Defendants  
19 Casey and Ballenger and included certifications by Defendants Killinger and Casey. The First  
20 Quarter 2008 Form 10-Q repeated the financial results set forth in the Company’s April 8, 2008  
21 press release. The First Quarter 2008 Form 10-Q continued to conceal the Company’s improper  
22 lending and, accounting practices and deficient risk management as well as the true extent of the  
23 Company’s loss exposure.  
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1           740. On June 2, 2008, WaMu announced that, effective July 1, 2008, the Company was  
2 stripping Defendant Killinger of his title of Chairman of the Board, and that Director Defendant  
3 Stephen Frank would replace him in the position of Chairman.

4           741. On June 9, 2008, the market gained a much fuller understanding of the magnitude  
5 and severity of the loss exposure facing WaMu. On this date, UBS Investment Research  
6 published a detailed analyst report, concluding, after an “extensive credit analysis of WM’s  
7 balance sheet,” that cumulative losses on WaMu’s mortgage portfolio will likely total close to  
8 \$21.7 billion through 2011, between 12.5 to 44% greater than the loss guidance of \$12 to \$19  
9 billion that the Company provided to the market in April 2008. Moreover, with respect to its  
10 \$21.7 billion loss estimate, UBS observed that it might still be too low, stating: “The attributes  
11 of WM’s remaining loan portfolio and broader economic weakening mean our bias is that losses  
12 could be worse than our projection.” This report also estimated that WaMu would record \$24.2-  
13 \$24.7 billion in incremental loan loss provisions between now and 2010. This report also  
14 concluded that WaMu would endure losses of \$4.45 per share in 2008 and of \$1.60 per share in  
15 2009.

16           742. On this news, the market price of WaMu common stock plummeted from its close  
17 of \$7.53 per share on June 6, 2008 to \$6.25 per share on June 9, 2008, a one day drop of 17%, on  
18 huge reported trading of 130,204,161 shares – *more than 22 times greater* than the average daily  
19 trading volume of WaMu common stock from October 19, 2005 (the first day of the Class  
20 Period) until October 16, 2007 (the day before the Company’s first partial disclosure).

21           743. Similarly, on June 24, 2008, Lehman Brothers issued a report predicting that  
22 WaMu would suffer mortgage losses in excess of the Company’s April 2008 loss guidance of \$12  
23 to \$19 billion over the next 3 to 4 years. Specifically, Lehman Brothers’ report estimated that  
24

1 WaMu's "lifetime real estate mortgage losses will be in the \$21 billion to \$28 billion range." On  
2 this news, the market price for WaMu's common stock dropped almost 3%, from a closing price  
3 of \$5.96 per share on June 23, 2008 to a closing price of \$5.80 per share on June 24, 2008, on  
4 substantial reported trading volume of 50,637,751 shares – **8.7 times greater** than the average  
5 daily trading volume of WaMu common stock from October 19, 2005 (the first day of the Class  
6 Period) until October 16, 2007 (the day before the Company's first partial disclosure).

7  
8 744. On July 14, 2008, Lehman Brothers issued another analyst report, further  
9 confirming its estimate of \$21 billion to \$28 billion for WaMu's lifetime real estate mortgage  
10 losses and predicting that "WM will take a \$4B provision in the 2Q08, building reserves to  
11 \$6.9B, producing another large loss for the quarter." Moreover, the report estimated that WaMu  
12 would report a loss of \$1.48 per share in the second quarter because: "As Washington Mutual  
13 builds reserves to cover these losses, it should remain unprofitable until credit costs normalize"  
14 around the second half of 2009. Significantly, on July 14, 2008, *Bloomberg News* reported on  
15 this analyst report, observing that Lehman Brothers' earnings forecast was more dire than other  
16 analysts' forecasts because, according to poll of 13 analysts, "the average estimate is for a loss of  
17 92 cents a share."  
18

19 745. On that same day, Ladenburg Thalmann analyst Richard Bove issued a report,  
20 questioning WaMu's financial viability and ability to stay afloat. In particular, Bove reported  
21 that WaMu was on the edge of "the danger zone." With this further news concerning the  
22 magnitude of the Company's loss exposure, and its implications for WaMu's financial condition,  
23 the market price of WaMu's common stock plummeted 35%, from a closing price of \$4.95 per  
24 share on July 11, 2008 to \$3.23 per share on July 14, 2008, on record reported trading volume  
25 trading volume of 210,678,306 shares – **more than 36 times greater** than the average daily  
26  
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1 trading volume of WaMu common stock from October 19, 2005 (the first day of the Class  
2 Period) until October 16, 2007 (the day before the Company's first partial disclosure).

3 746. After the close of the market on July 14, 2008, in an attempt to mitigate any  
4 further drops in the price of its common stock – which could have dire consequences for the  
5 thrift's survival – WaMu issued a press release, claiming that the Company's was sufficiently  
6 capitalized and had excess liquidity of more than \$40 billion. The Company's mitigation efforts  
7 were successful. As a result of this press release, the market price of WaMu's stock rebounded  
8 slightly, rising to \$5.92 per share in the days following this announcement. This was a false and  
9 misleading disclosure because the Company failed to disclose its improper lending and,  
10 accounting practices and deficient risk management as well as the true extent of the Company's  
11 loss exposure.  
12

13 747. After the markets closed on July 22, 2008 and less than ten days after it  
14 misleadingly calmed concerns about the Company's financial strength, WaMu once again  
15 shocked the market. Specifically, WaMu announced its second quarter 2008 financial results,  
16 including that the Company suffered a net loss of \$3.3 billion, more than 65% greater than the  
17 Company's first quarter 2008 net loss of \$1.14 billion, driven by a significant increase in its loan  
18 loss reserves. On a diluted per share basis, the Company reported a loss of \$3.34 per share  
19 (excluding a one-time earnings reduction related to the Company's issuance of capital in  
20 connection with the TPG deal). The Company further announced that it increased its loan loss  
21 reserves by \$3.74 billion to \$8.46 billion and that it took a \$5.9 billion loan loss provision in the  
22 quarter, an increase of 40% from the \$3.5 billion provision that the Company recorded in the first  
23 quarter 2008. In explaining its increased loan loss provision, the Company stated that,  
24 "approximately one third of the second quarter provision for loan losses related to significant  
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1 changes in key assumptions the company used to estimate incurred losses in its loan portfolio.”  
2 Specifically, the Company shortened the time period used to evaluate defaults for its prime  
3 mortgage portfolio to one year from three years “to reflect the evolving risk profile of the loan  
4 portfolio and adjusted its severity assumptions for all single family mortgages to reflect the  
5 continuing decline in home prices.”  
6

7 748. In addition, WaMu announced that its unpaid mortgages, foreclosed homes and  
8 other nonperforming assets continued to increase during the second quarter. For example, WaMu  
9 stated that its net charge-offs rose to \$2.17 billion from \$1.37 billion in the prior quarter and  
10 nonperforming assets increased \$2 billion, representing 3.62% of total assets compared with  
11 2.87% at the end of the prior quarter. WaMu also announced that it expected cumulative losses  
12 in its residential mortgage portfolio to total \$19 billion, the high end of its previous guidance,  
13 and that 2008 would be the peak year for provisioning.  
14

15 749. Also on July 22, WaMu held a conference call to discuss the Company’s second  
16 quarter 2008 financial results. Defendants Killinger and Casey participated in the call along with  
17 WaMu’s new Chief Enterprise Risk Officer John McMurray. During the call, Killinger, Casey  
18 and Murray reviewed the results set forth in the Company’s press release. They also explained  
19 that, in 2008, the Company’s Option ARM loans experienced the fastest rise in delinquency rates  
20 and that they expected “other prime loans, which are mostly 5 and 7 year hybrids, to follow  
21 Option ARMs closely.” According to McMurray, home equity loans and subprime mortgages  
22 had experienced high delinquency rates during the late 2006 to late 2007 time period. Moreover,  
23 during the call, the Company announced that it “significantly reduced our production of new  
24 mortgages and tightened underwriting standards against our loan portfolio.” Similarly, the  
25  
26  
27



1 Company also announced it had “eliminated negatively amortizing products including the Option  
2 ARM from our product line.”

3 750. The market reacted swiftly to this news, driving down the stock price 20% from a  
4 closing price of \$5.82 per share on July 22, 2008 to a closing price of \$4.65 per share on July 23,  
5 2008, on massive reported trading volume of 208,124,873 shares – *more than 35 times greater*  
6 than the average daily trading volume of WaMu common stock from October 19, 2005 (the first  
7 day of the Class Period) until October 16, 2007 (the day before the Company’s first partial  
8 disclosure). Indeed, Dominion Bond Rating Service Limited and Standard & Poor’s downgraded  
9 WaMu’s ratings. Moody’s placed WaMu and its bank subsidiary on review for a downgrade to  
10 junk status. Piper Jaffray downgraded WaMu to “Sell” and Merrill Lynch cut the Company’s  
11 rating to “Underperform.” Similarly, during an interview with Susie Gharib on the Nightly  
12 Business Report, Ladenburg Thalmann analyst Richard Bove described WaMu’s position as  
13 follows:  
14  
15

16 It’s in very bad shape...when you take a look at its non-performing  
17 assets, they went up by \$2 billion in the quarter. So despite the  
18 fact that they wrote off \$2 billion in bad loans, they actually still  
19 increased the non-performing assets by \$2 billion, which means  
20 that the non-performing assets are growing at a faster pace than  
21 they can write them off. That is not a good sign.

22 751. With the Company’s release of its second quarter 2008 financial results, the  
23 market gained a much greater understanding of the Company’s loss exposure and financial  
24 condition. As a result, at least in part, of the disclosures set forth above, from October 17, 2007  
25 until July 23, 2008, as the magnitude and severity of the Company’s loss exposure caused by its  
26 improper lending and accounting practices and deficient risk management was revealed  
27 piecemeal to the investing public, the Company’s stock price dropped from \$33.07 per share to  
28 \$4.65 per share, a decline of more than 85%.



752. The price of WaMu's other securities also fell as a result, at least in part, of the disclosures of the Company's improper lending practices, poor quality loans and loss exposure. For example, on November 1, 2007, when Attorney General Cuomo filed the NYAG Complaint, alleging that WaMu had engaged in unlawful appraisal practices (as set forth above), the market price of WaMu's depositary shares representing 1/40,000<sup>th</sup> interest in a share of Series K Perpetual Non-Cumulative floating rate preferred stock (the "Series K Stock") fell 7%, from \$21.64 per share on October 31, 2007 to \$20.10 per share on November 1, and dropped another 6.5% to \$18.81 per share on November 2, 2007 as analysts tried to quantify the severity of the allegations. WaMu's debt securities also dropped, on average, 1% on this news. Similarly, on November 7, 2008, when Attorney General Cuomo announced the expansion of his investigation of WaMu's appraisal practices and the Company announced that its loan loss provision could exceed \$1.8 billion in the first quarter 2008 (as set forth above), WaMu's Series K Stock fell almost 8%, from \$18.30 per share on November 6, 2007 to close at \$16.88 per share on November 7, 2007, and dropped another 2% to close at \$16.57 per share on November 8, 2007. WaMu's debt securities also dropped, on average, 2% on this news. Additionally, on March 6, 2008, when numerous rating agencies downgraded WaMu because of credit concerns (as set forth above), WaMu's Series K Stock dropped 5%, its shares of 7.75% Series R Non-Cumulative Perpetual Convertible Preferred Stock (the "Series R Stock") dropped 7% and its debt securities dropped, on average, 2.8%. In another example, on July 14, 2008, when analysts predicted that WaMu would suffer lifetime real estate mortgage losses between \$21 billion and \$28 billion and seriously questioned the Company's viability as a result of these losses (as set forth above), WaMu's Series K Stock dropped 36%, its Series R Stock dropped 24%, and its debt securities dropped, on average, 8%.

753. Thus, as the truth about the consequences of WaMu's improper lending and accounting practices and loss exposure was revealed to the market, the market price of WaMu's securities declined substantially. For example, the market price of the Series K Stock declined 68%, from \$23.49 per share on October 17, 2007 to \$7.53 per share on July 23, 2008. The market price of WaMu's Series R Stock fell 51%, from \$991.25 per share on December 12, 2007 (first available pricing data for this security) to \$485.98 per share on July 23, 2008. The market price of WaMu's 5.5% notes due August 24, 2011 also dropped, declining almost 21%, from \$100.79 per note on October 18, 2007 to \$80.00 per note on July 23, 2008. Similarly, the market price of WaMu's 7.25% notes due November 1, 2017 dropped almost 28%, from \$99.41 per note on October 29, 2007 to \$71.99 per note on July 23, 2008. The market price of WaMu's 7.250% Notes also declined during the Class Period.

#### **X. LOSS CAUSATION**

754. Defendants' wrongful conduct, as alleged herein, directly and proximately caused the economic loss suffered by Plaintiffs and the Class. Throughout the Class Period, the market prices of WaMu securities were inflated by the material omissions and materially false and misleading statements made by the Company and the Officer Defendants, identified above, and, as a result, Plaintiffs and the Class purchased WaMu securities at artificially inflated prices. When the truth about WaMu was revealed to the market and investors, the price of WaMu's securities declined in response, as the artificial inflation caused by WaMu's and the Officer Defendants' material omissions and false and misleading statements was removed from the price of WaMu's securities, thereby causing substantial damage to Plaintiffs and other members of the Class.

1           755. Indeed, during the Class Period, WaMu common stock traded as high as \$46.48  
2 per share on June 1, 2006, and closed at \$35.20 per share just days before the Company's  
3 October 17, 2007 conference call and press release, when the first partial disclosures about  
4 WaMu's true condition were made. Over the next eight and a half months, in response to several  
5 additional partial disclosures that revealed more about the Company's true financial condition,  
6 the market reacted, and WaMu's stock price partially corrected as WaMu's stock price was  
7 significantly driven downward. The Company and the Officer Defendants mitigated the impact  
8 of those disclosures and prevented the full truth about WaMu from being revealed by making  
9 contemporaneous false and misleading statements that minimized and denied the facts being  
10 revealed to the market. As the market gained a more complete understanding of the magnitude  
11 of the loss exposure facing WaMu and the implications for WaMu's financial condition, the price  
12 of WaMu's common stock plummeted to \$4.65 per share on July 23, 2008. As a result, at least in  
13 part, of the truth emerging about the Company's improper lending practices, poor quality loans,  
14 and loss exposure, the market price of WaMu common stock fell more than \$28 per share, from  
15 \$33.07 per share on October 17, 2007 to \$4.65 per share on July 23, 2007. The price of WaMu's  
16 other equity and debt securities also fell, at least in part, as a result of the disclosures of the  
17 Company's improper lending practices, poor quality loans, and loss exposure.  
18  
19

20           756. The specific dates of the adverse disclosures and the corresponding declines in the  
21 price of WaMu securities are set forth above in Section IX above.  
22

23           757. It was entirely foreseeable to WaMu and the Officer Defendants that concealing  
24 from investors the Company's improper lending and accounting practices would artificially  
25 inflate the price of WaMu securities. It was similarly foreseeable to the Company and the  
26 Officer Defendants that the ultimate revelation of that misconduct, and of the Company's true  
27

1 condition, would cause the price of WaMu securities to drop significantly as the inflation caused  
2 by their misstatements was corrected. Accordingly, the conduct of the Company and the Officer  
3 Defendants, as alleged herein, proximately caused foreseeable losses and damages to Plaintiffs  
4 and members of the Class.

5  
6 758. Specifically, the misleading omissions and statements detailed above falsely  
7 assured investors, among other things, that WaMu employed “*prudent*,” “*conservative*,”  
8 “*disciplined*” and “*tightened underwriting standards*,” that WaMu had “*rigorous credit*  
9 “*standards*,” “*strong credit quality*” and an “*effective*” “*risk management strategy*,” an  
10 “*appropriate level of reserving*” and *designed, established and maintained an effective system*  
11 *of internal controls*. Those statements were materially false and misleading due to the  
12 Company’s undisclosed origination of high-risk loans, improper appraisal and lending practices,  
13 use of dangerously lax underwriting standards, deficient credit risk management, inadequate  
14 provisioning for loan losses, failure to maintain effective internal controls, and failure to report  
15 its financial statements in accordance with GAAP during the Class Period.

16  
17 759. WaMu and the Officer Defendants’ material omissions and materially false and  
18 misleading statements caused the market to believe that the Company’s loss exposure was  
19 contained and properly managed; caused the Company’s financial reporting to be in violation of  
20 GAAP; and conveyed the impression that the Company was financially stronger and more  
21 profitable than it actually was. The prices of WaMu’s securities during the Class Period were  
22 affected by those omissions and false statements, and were artificially inflated as a result thereof.  
23  
24 Thus, the precipitous declines in the value of WaMu’s securities purchased by the Class were a  
25 direct, foreseeable and proximate result of the partial disclosures of WaMu’s true condition and  
26  
27

1 of the July 22, 2008 disclosure which more fully revealed the magnitude of the Company's loss  
2 exposure and true financial condition.

3 760. Moreover, the fact that WaMu's unlawful appraisal and improper lending  
4 practices, deficient risk management, and inadequate provisioning for loan loss reserves  
5 triggered investigations by the New York Attorney General, the SEC and the OTS was also an  
6 entirely foreseeable consequence of the misconduct complained of herein.  
7

8 761. Although not necessarily because of the detailed facts set forth above concerning  
9 loss causation, as further indicia of the adequacy of loss causation as pled by Lead Plaintiff, Lead  
10 Counsel has obtained an expert opinion and analysis from an experienced loss causation expert  
11 regarding this matter. Chad Coffman is an expert on loss causation in the securities class action  
12 context, economic damages and securities valuation. He has been retained by Lead Counsel in  
13 connection with Lead Plaintiff's investigation to evaluate the economic impact of WaMu's  
14 allegedly false statements to the investing public on the market price of WaMu's securities,  
15 including the causal linkage between the revelation of the truth about WaMu and the economic  
16 harm suffered by WaMu investors by the decline in the price of those securities. Mr. Coffman's  
17 opinion concerning these issues is attached hereto as Appendix 6 (the "Coffman Declaration").  
18

19 762. As explained in the Coffman Declaration, Mr. Coffman is the President and a  
20 founder of Winnemac Consulting, LLC ("Winnemac"), a firm specializing in the application of  
21 economics, finance, statistics, technology, securities valuation, and accounting principles in the  
22 areas of securities fraud damages, valuation, labor discrimination, antitrust, intellectual property  
23 and securities trading practices. Prior to founding Winnemac in March 2008, Mr. Coffman was a  
24 Principal at Chicago Partners, LLC. Mr. Coffman spent twelve years at Chicago Partners, and  
25 was responsible for conducting and managing large and complex litigation consulting matters  
26  
27

1 across a wide variety of disciplines, including securities valuation and damages, labor  
2 discrimination and anti-trust. Mr. Coffman has conducted loss causation and damages analyses  
3 for numerous securities actions arising under Section 10(b) of the Exchange Act and Section 11  
4 of the Securities Act, including for some of the largest securities actions in history, such as the  
5 *Enron*, *WorldCom*, *Parmalat* and *Tyco* securities class actions. Mr. Coffman has also been  
6 engaged numerous times as a valuation expert both in and out of the securities litigation context,  
7 on behalf of plaintiffs, defendants, and director and officer insurance policy carriers. Mr.  
8 Coffman has also worked for prominent mediator and former Judge, the Honorable Daniel  
9 Weinstein (Ret.), providing neutral expert analysis and input in securities litigations and other  
10 matters. Mr. Coffman holds a Bachelor of Arts, *magna cum laude*, in economics from Knox  
11 College and a Masters in Public Policy from the University of Chicago.

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13  
14 763. As explained in the Coffman Declaration, based upon his review of publicly-  
15 available information concerning WaMu and the allegations in the Complaint (including the  
16 disclosures and analyst reports set forth in Section IX), it is Mr. Coffman's expert opinion that  
17 Lead Plaintiff has (i) set forth a coherent economic theory of how and why the alleged  
18 misconduct caused the market prices of WaMu securities to be inflated; and (ii) provided a  
19 specific, logical and economically coherent theory of the causal linkage between the disclosures  
20 of the truth about WaMu, the resultant declines in the market prices of WaMu securities and the  
21 losses incurred by Plaintiffs and the Class. In short, Mr. Coffman's expert opinion establishes  
22 that loss causation has been adequately asserted in this action for purposes of this stage of the  
23 case.  
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**XI. PRESUMPTION OF RELIANCE**

764. Plaintiffs are entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. U.S.*, 406 U.S. 128 (1972), because the claims asserted herein against defendants are predicated in part upon material omissions of fact that Defendants had a duty to disclose.

765. In the alternative, Plaintiffs are entitled to a presumption of reliance on Defendants' material misrepresentations and omissions pursuant to the fraud-on-the-market doctrine because, at all relevant times, the market for WaMu securities was open, efficient and well-developed for the following reasons, among others:

- (b) WaMu's common and preferred stock met the requirements for listing, and were listed and actively traded on the NYSE, a highly efficient and automated market;
- (c) The average daily trading volume for WaMu common stock during the Class Period was 14,778,603 shares;
- (d) WaMu's debt securities, such as its notes and bonds, were actively traded on multiple exchanges and the Over the Counter Market, all highly efficient markets;
- (e) WaMu's securities, including its debt securities, were rated by Moody's, Standard & Poor's and Fitch Ratings;
- (f) WaMu was followed by numerous securities analysts employed by firms including Bear Stearns & Co. Inc.; Citigroup, Inc.; Credit Suisse; D.A. Davidson & Co.; Fox-Pitt Kelton Cochran Caronia Waller; Freidman, Billings, Ramsey & Co., Inc.; Lehman Brothers; Merrill Lynch, Pierce, Fenner & Smith Inc.; Morningstar, Inc.; Punk Ziegel & Company; and

1 Keefe, Bruyette & Woods, among others, who wrote reports about the  
2 Company and the value of its securities that were publicly available and  
3 entered the public marketplace. Indeed, there was extensive securities  
4 analyst coverage of WaMu during the Class Period.

5 (g) WaMu regularly communicated with public investors through established  
6 market communication mechanisms, including through regular press  
7 releases, which were carried by national and international news wires, and  
8 through other wide ranging public disclosures, such as communications  
9 and conferences with investors, the financial press and other similar  
10 reporting services.

11 (h) As a public company, WaMu filed periodic public reports with the SEC;

12 (i) WaMu met the SEC's requirements to register debt and equity securities  
13 filed on Form S-3 and, in fact, filed a Form S-3 in connection with the  
14 Offerings, among other SEC filings, as set forth in Section XIV, below;

15 (j) There is substantial and regular pricing available for WaMu's securities.  
16 In addition to there being significant pricing data available for WaMu's  
17 debt securities that traded on exchanges, there is also substantial pricing  
18 date available for WaMu's debt securities that traded on the Over the  
19 Counter Market. Specifically, there is an average of greater than ten  
20 pricing sources for those securities that did not trade on any exchange.

21 766. As a result of the foregoing, the market for WaMu securities promptly digested  
22 current information regarding WaMu from all publicly available sources and reflected such  
23 information in the price of WaMu's securities. Under these circumstances, purchasers of WaMu  
24



securities during the Class Period suffered similar injury through their purchase of WaMu securities at artificially inflated prices and a presumption of reliance applies.

## **XII. INAPPLICABILITY OF STATUTORY SAFE HARBOR**

767. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false or misleading statements pleaded in this Complaint. The statements alleged to be false or misleading herein all relate to then-existing facts and conditions. In addition, to the extent certain of the statements alleged to be false or misleading may be characterized as forward-looking, they were not adequately identified as forward-looking statements when made, and there were no meaningful cautionary statements identifying important facts that could cause actual results to differ materially from those in the purportedly forward-looking statements. To the extent that the statutory safe harbor is intended to apply to any forward-looking statements pleaded herein, WaMu and the Officer Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, each of these Defendants had actual knowledge that the particular forward-looking statement was materially false or misleading. In addition, to the extent any of the statements set forth above were accurate when made, they became inaccurate or misleading because of subsequent events, and WaMu and the Officer Defendants failed to update those statements which later became inaccurate.

## **XIII. CLAIMS BROUGHT PURSUANT TO THE EXCHANGE ACT**

### **FIRST CLAIM FOR RELIEF**

#### **For Violations of Section 10(b) of The Exchange Act and Rule 10b-5 (Against Defendants WaMu, Killinger, Casey, Cathcart, Rotella and Schneider)**

768. Plaintiffs repeat and re-allege each and every allegation contained above as if fully set forth herein.

1           769. During the Class Period, Defendants WaMu, Killinger, Casey, Cathcart, Rotella  
2 and Schneider disseminated or approved the false statements specified herein, which they knew  
3 or recklessly disregarded were misleading in that they failed to disclose material facts necessary  
4 in order to make the statements made, in light of the circumstances under which they were made,  
5 not misleading, and they contained material misrepresentations.

6  
7           770. These Defendants violated Section 10(b) of the Exchange Act and Rule 10b-5  
8 thereunder in that they: (a) employed devices, schemes, and artifices to defraud; (b) made untrue  
9 statements of material facts or omitted to state material facts necessary in order to make the  
10 statements made, in light of the circumstances under which they were made, not misleading;  
11 and/or (c) engaged in acts, practices, and a course of business that operated as a fraud or deceit  
12 upon Plaintiffs and others similarly situated in connection with their purchases of WaMu  
13 securities during the Class Period. As detailed herein, the misrepresentations contained in, or the  
14 material facts omitted from, these Defendants' public statements, including SEC filings,  
15 concerned, among other things, the Company's loan quality risk management appraisal policies  
16 and practices, underwriting policies and practices, understatements of the Company's loan loss  
17 provision and Allowance and overstatements of the Company's net income, earnings per share  
18 and assets.

19  
20           771. These Defendants, individually and in concert, directly and indirectly, by the use  
21 of means or instrumentalities of interstate commerce and/or of the mails, engaged and  
22 participated in a continuous course of conduct that operated as a fraud and deceit upon Plaintiffs  
23 and the Class; made various false and/or misleading statements of material facts and omitted to  
24 state material facts necessary in order to make the statements made, in light of the circumstances  
25 under which they were made, not misleading; made the above statements with a severely  
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reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and did: (i) deceive the investing public, including Plaintiffs and the Class, regarding, among other things, WaMu's financial results, including but not limited to WaMu's net income, earnings per share and assets, improper lending and accounting practices, deficient risk management, and inadequate loan loss provisions; (ii) artificially inflate and maintain the market price of WaMu securities; and (iii) cause Plaintiffs and other members of the Class to purchase WaMu securities at artificially inflated prices.

772. Defendant WaMu is liable for all materially false and misleading statements made during the Class Period, as alleged above, including the false and misleading statements in:

- i. WaMu's press release of October 19, 2005;
- ii. WaMu's Form 10-Q, filed with the SEC on November 7, 2005;
- iii. WaMu's press release of January 18, 2006;
- iv. WaMu's Form 10-K, filed with the SEC on March 15, 2006;
- v. WaMu's press release of April 18, 2006;
- vi. WaMu's Form 10-Q, filed with the SEC on May 10, 2006;
- vii. WaMu's press release of July 19, 2006;
- viii. WaMu's Form 10-Q, filed with the SEC on August 9, 2006;
- ix. WaMu's Form 10-Q/A, filed with the SEC on August 10, 2006;
- x. WaMu's Form 10-K/A, filed with the SEC on August 9, 2006;
- xi. WaMu's press release of October 18, 2006;
- xii. WaMu's Form 10-Q, filed with the SEC on November 9, 2006;
- xiii. WaMu's press release of January 17, 2007;
- xiv. WaMu's Form 10-K, filed with the SEC on March 1, 2007;
- xv. WaMu's press release of April 17, 2007;

- xvi. WaMu's Form 10-Q, filed with the SEC on May 10, 2007;
- xvii. WaMu's press release of July 18, 2007;
- xviii. WaMu's Form 10-Q, filed with the SEC on August 9, 2007;
- xix. WaMu's press release of October 5, 2007;
- xx. WaMu's press release of October 17, 2007;
- xxi. WaMu's press release of December 10, 2007;
- xxii. WaMu's press release of January 17, 2008;
- xxiii. WaMu's press release of April 8, 2008; and
- xxiv. WaMu's press release of July 14, 2008.

773. WaMu is also liable for the false and misleading statements made in the Registration Statement filed with the SEC on Form S-3AR on January 9, 2006; the prospectus supplements dated August 21, 2006, and filed with the SEC on Forms 424B2 on August 21, 2006 and August 22, 2006, respectively, and on Form 424B5 on August 23, 2006; prospectus supplements dated September 11, 2006, and filed with the SEC on Form 424B2 and Form 424B5 on September 11, 2006 and September 13, 2006, respectively; and prospectus supplements dated October 25, 2007, and filed with the SEC on Form 424B2 and Form 424B5 on October 25, 2007 and October 29, 2007, respectively; and the prospectus supplements dated December 10, 2007 and December 11, 2007, and filed with the SEC on Form 424B5 on December 11, 2007 and December 13, 2007. These filings were materially false and misleading because, among other reasons, they included materially misstated financial results and/or incorporated by reference Forms 10-Q and Form 10-K that materially misstated WaMu's financial results.

774. WaMu is further liable for the false and misleading statements made by WaMu officers in press releases and during conference calls and at conferences with investors and

analysts, as alleged above, as the makers of such statements and under the principle of respondeat superior.

775. Defendants Killinger, Casey, Cathcart, Rotella and Schneider, as top executive officers of the Company, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers of the Company, each of these Defendants was able to and did control the content of the public statements disseminated by WaMu. These Defendants had direct involvement in the daily business of the Company and participated in the preparation and dissemination of the WaMu's false and misleading statements, as set forth in ¶771 above.

776. In addition, Defendants Killinger, Casey, Cathcart, Rotella and Schneider are liable for, among other material omissions and false and misleading statements, the false and misleading statements they made and/or signed as follows:

Defendant Killinger:

- i. Defendant Killinger signed Forms 10-K (for the years ended December 31, 2005 through 2007); the Registration Statement filed with the SEC on Form S-3AR on January 9, 2006; and certifications in Forms 10-K and Forms 10-Q (for the quarter ended September 30, 2005 through the quarter ended March 30, 2008, including for the years ended December 31, 2005 through 2007).
- ii. Defendant Killinger made statements during numerous conference calls and conferences during the Class Period, including: the 3<sup>rd</sup> Quarter 2005 WaMu Earnings Conference Call (10/19/2005); the WaMu 2005 New York Investor Day (11/15/2005); the 4<sup>th</sup> Quarter 2005 WaMu Earnings

1 Conference Call (1/18/2006); the 1<sup>st</sup> Quarter 2006 WaMu Earnings  
2 Conference Call (4/18/2006); the Stanford C. Bernstein & Co. Strategic  
3 Decisions Conference (6/1/2006); the 2<sup>nd</sup> Quarter 2006 WaMu Earnings  
4 Conference Call (7/19/2006); WaMu's 2006 Investor Day (9/6/2006 and  
5 9/7/2006); Lehman Brothers 4<sup>th</sup> Annual Conference (9/13/2006); the 3<sup>rd</sup>  
6 Quarter 2006 WaMu Earnings Conference Call (10/18/2006); the Merrill  
7 Lynch Banking & Financial Services Conference (11/16/2006); the  
8 Goldman Sachs Financial Services CEO Conference (12/13/2006); the 4<sup>th</sup>  
9 Quarter 2006 WaMu Earnings Conference Call (1/17/2007); the CitiGroup  
10 2007 Financial Services Conference (1/30/2007); the 1<sup>st</sup> Quarter 2007  
11 WaMu Earnings Conference Call (4/17/2007); Lehman Brothers 5<sup>th</sup>  
12 Annual Financial Services Conference (9/10/2007); the 3<sup>rd</sup> Quarter 2007  
13 WaMu Earnings Conference Call (10/17/2007); WaMu's 2007 Annual  
14 Investor Day Conference (11/7/2007); and, the 4<sup>th</sup> Quarter 2007 WaMu  
15 Earnings Conference Call (1/17/2008).

- 16  
17  
18 iii. Defendant Killinger made statements in and was directly responsible for  
19 other statements made in WaMu press releases filed with the SEC as Form  
20 8-Ks, including on the following dates among others: 10/19/2005;  
21 1/18/2006; 4/18/2006; 7/19/2006; 10/18/2006; 1/17/2007; 4/17/2007;  
22 7/18/2007; 10/5/2007; 10/17/2007; 11/1/2007; 12/10/2007; 12/21/2007;  
23 1/17/2008; and, 4/8/2008.  
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Defendant Casey:

iv. Defendant Casey signed Forms 10-K (for the years ended December 31, 2005 through 2007); the Registration Statement filed with the SEC on Form S-3AR on January 9, 2006; and certifications in Forms 10-K and Forms 10-Q (for the quarter ended September 30, 2005 through the quarter ended March 30, 2008, including for the years ended December 31, 2005 through 2007).

v. Defendant Casey made numerous statements during conference calls and conferences during the Class Period, including: the 4<sup>th</sup> Quarter 2005 WaMu Earnings Conference Call (1/16/2006); the 1<sup>st</sup> Quarter 2006 WaMu Earnings Conference Call (4/18/2006); the 2006 WaMu Shareholder Meeting (4/18/2006); the 2<sup>nd</sup> Quarter 2006 WaMu Earnings Conference Call (7/19/2006); the 3<sup>rd</sup> Quarter 2006 WaMu Earnings Conference Call (10/18/2006); the 1<sup>st</sup> Quarter 2007 WaMu Earnings Conference Call (4/17/2007); the 3<sup>rd</sup> Quarter 2007 WaMu Earnings Conference Call (10/17/2007); WaMu's 2007 Annual Investor Day Conference (11/7/2007); and, the 4<sup>th</sup> Quarter 2007 WaMu Earnings Conference Call (1/17/2008).

Defendant Cathcart:

vi. Defendant Cathcart made statements in and was directly responsible for other statements made during conference calls and conferences with investors and analysts, including from October 19, 2005 through April 29,

2008, and including WaMu's 2006 Investor Day (9/6/2006 and 9/7/2006) and WaMu's 2007 Annual Investor Day Conference (11/7/2007).

Defendant Rotella:

vii. Defendant Rotella made statements in and was directly responsible for other statements made during conference calls and conferences with investors and analysts during the Class Period, including: the 4<sup>th</sup> Quarter 2005 WaMu Earnings Conference Call (1/18/2006); the D.A. Davidson & Co. Financial Services Conference (5/9/2006); WaMu's 2006 Investor Day (9/6/2006 and 9/7/2006); the 1<sup>st</sup> Quarter 2007 WaMu Earnings Conference Call (4/17/2007); WaMu's 2007 Annual Investor Day Conference (11/7/2007); and, the 4<sup>th</sup> Quarter 2007 WaMu Earnings Conference Call (1/17/2008).

Defendant Schneider:

viii. Defendant Schneider made statements in and was directly responsible for other statements made during conference calls and conferences with investors and analysts during the Class Period, including the WaMu 2005 New York Investor Day (11/15/2005); WaMu's 2006 Investor Day (9/6/2006); and WaMu's 2007 Annual Investor Day Conference (11/7/2007).

777. As described above, these Defendants acted with scienter throughout the Class Period, in that they either had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them.



1           778. Specifically, the above allegations establish a strong inference that these  
2 Defendants knew or should have known that WaMu's reported annual financial results for the  
3 years 2005 through 2007, as filed with the SEC in WaMu's Forms 10-K and other SEC filings,  
4 and its reported quarterly financial results for the quarters starting with the third quarter 2005  
5 through the first quarter of 2008, and disseminated to the investing public, were materially  
6 misstated and were not presented in accordance with GAAP, and that WaMu did not have  
7 adequate internal controls, as represented to the public in, for example, the Form 10-K issued for  
8 the years-ended December 31, 2005, December 31, 2006 and December 31, 2007.

10           779. The allegations set forth above establish a strong inference that these Defendants  
11 acted with scienter in misrepresenting the quality of the Company's loans, lending and  
12 accounting practices, credit risk management and, consequently, the financial condition of the  
13 Company during the Class Period. The allegations pertaining to the overall extent and  
14 widespread nature of the fraud at WaMu, which resulted in the enormous loss exposure to the  
15 Company and material overstatements of net income, among other key measures, establish a  
16 strong inference that Defendants WaMu, Killinger, Casey, Cathcart, Rotella and Schneider acted  
17 with scienter in misrepresenting the Company's financial condition during the Class Period.

19           780. Plaintiffs and the Class have suffered damages in that they paid artificially  
20 inflated prices for WaMu securities. Plaintiffs and the Class would not have purchased WaMu  
21 securities at the prices they paid, or at all, if they had been aware that the market price had been  
22 artificially and falsely inflated by Defendants' misleading statements.

24           781. As a direct and proximate result of these Defendants' wrongful conduct, Plaintiffs  
25 and the other members of the Class suffered damages in connection with their purchases of  
26 WaMu securities during the Class Period.

**SECOND CLAIM FOR RELIEF**

**For Violations of Section 20(a) of The Exchange Act  
(Against Defendants Killinger, Casey, Cathcart, Rotella, Schneider, Woods and Ballenger)**

782. Plaintiffs repeat and re-allege each and every allegation contained above as if fully set forth herein.

783. This Count is asserted against Defendants Killinger, Casey, Cathcart, Rotella, Schneider, Woods and Ballenger for violations of Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of all members of the Class.

784. As alleged in detail above, WaMu committed a primary violation of the federal securities laws, through its knowing and/or reckless dissemination of materially false and misleading statements and omissions throughout the Class Period.

785. During their tenures as officers and/or directors of WaMu, each of these Defendants was a controlling person of WaMu within the meaning of Section 20(a) of the Exchange Act. By reason of their positions of control and authority as officers and/or directors of WaMu, these Defendants had the power and authority to cause WaMu to engage in the wrongful conduct complained of herein. As set forth in detail, above, the Defendants named in this Count were able to and did control, directly and indirectly, exert control over WaMu, including the content of the public statements made by WaMu during the Class Period, thereby causing the dissemination of the false and misleading statements and omissions of material facts as alleged herein.

786. In their capacities as senior corporate officers of the Company, and as more fully described above, Defendants Killinger, Casey, Cathcart, Rotella and Schneider had direct involvement in the day-to-day operations of the Company and in WaMu's financial reporting and accounting functions. Each of these Defendants was also directly involved in providing false

1 information and certifying and/or approving the false financial statements disseminated by  
2 WaMu during the Class Period. Further, as detailed above, Defendants Killinger, Casey,  
3 Cathcart, Rotella and Schneider had direct involvement in the presentation and/or manipulation  
4 of false financial reports included within the Company's press releases and filings with the SEC.

5  
6 787. Defendant Killinger served as WaMu's Chairman of the Board from 1991 until  
7 June 30, 2008. In addition, Defendant Killinger has served as WaMu's CEO since 1990 and as  
8 President from 1988 through 2004. In this dual capacity as the senior manager of the Company  
9 and as the head of the Board, Defendant Killinger had ultimate control over the actions of  
10 WaMu.

11 788. According to WaMu's Forms 10-K for 2005 through 2007, Defendant Killinger  
12 "established the Executive Committee in 1990 to facilitate and coordinate decision making and  
13 communication among the most senior executive officers of the Company who, as a committee,  
14 determine the Company's strategic direction." Defendants Killinger, Casey, Rotella and  
15 Schneider participated as members of the Executive Committee throughout the Class Period.  
16 Defendant Cathcart was a member of the Committee from December 2005 until April 2008. As  
17 alleged in detail, in Sections VI and VII, above, these Defendants controlled and managed  
18 WaMu's policies, practices and overall business.

19 789. Furthermore, Defendants Killinger, Casey, Cathcart, Rotella and Schneider all  
20 received various written and oral reports from different divisions of the Company on a routine  
21 basis. The Officer Defendants' knowledge of and participation in the Company's affairs through  
22 the various reports they received and/or had access to are described in Sections VI and VII,  
23 above.  
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1           790. Defendant Woods served as WaMu's Controller and principal accounting officer  
2 from December 2005 until March 2007. Defendant Ballenger has served as the Company's  
3 Controller and principal accounting officer since March 2007. In the position of Controller,  
4 Defendants Woods and Ballenger had direct involvement in the day-to-day operations of the  
5 Company and in WaMu's financial reporting and accounting functions.  
6

7           791. Confidential Witness 80 served as a Senior Vice President for WaMu's  
8 Accounting Policy group from June 2006 to November 2007. In this position, CW 80 reported  
9 directly to Defendant Woods and then to Defendant Ballenger. According to CW 80, Defendant  
10 Woods and Ballenger were responsible for reviewing and setting WaMu's accounting policies.  
11 In addition, according to CW 80, Defendants Woods and Ballenger participated in regular  
12 meetings with other senior WaMu managers (including Defendants Casey and Cathcart)  
13 concerning WaMu's accounting policies and practices, including WaMu's Allowance.  
14 Defendants Ballenger and Woods also controlled the contents of and had direct involvement in  
15 the presentation and/or manipulation of the false financial reports including within the  
16 Company's filings with the SEC. This is evidenced by the fact that these Defendants signed  
17 many of the false financial statements at issue herein. For example, Woods signed the  
18 Company's Form 10-Ks for the years ended December 31, 2005 and December 31, 2006 and  
19 Form 10-Qs for the quarters ended March 31, 2006, June 30, 2006 and September 2006.  
20 Similarly, Ballenger signed the Company's Form 10-K for the year ended December 31, 2007  
21 and the Forms 10-Q for the quarters ended March 31, 2007, June 30, 2007 and September 30,  
22 2007. Thus, the Defendants Ballenger and Woods controlled the Company's accounting  
23 practices and were directly involved in the preparation and discrimination of the Company's  
24 financial results, including the materially false and misleading statements contained therein.  
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1           792. By reason of their positions as officers of WaMu, and more specifically as  
2 controlling officers – as can be seen by their corresponding ability to influence and control  
3 WaMu – each of these Defendants is a “controlling person” within the meaning of Section 20(a)  
4 of the Exchange Act and had the power and influence to direct the management and activities of  
5 the Company and its employees, and to cause the Company to engage in the unlawful conduct  
6 complained of herein. Because of their positions, these Defendants had access to adverse non-  
7 public financial information about the Company and acted to conceal the same, or knowingly or  
8 recklessly authorized and approved the concealment of the same. Moreover, each of the  
9 Defendants was also involved in providing false information and certifying and/or approving the  
10 false financial statements disseminated by WaMu during the Class Period. Each of these  
11 Defendants was provided with or had access to copies of the Company’s reports, press releases,  
12 public filings and other statements alleged by Plaintiffs to be misleading prior to and/or shortly  
13 after these statements were issued and ad the ability to prevent the issuance of the statements or  
14 cause the statements to be corrected.

15  
16  
17           793. As set forth above, WaMu violated Section 10(b) of the Exchange Act by its acts  
18 and omissions alleged in this Complaint. By virtue of their positions as controlling persons of  
19 WaMu and as a result of their own aforementioned conduct, the Defendants named in this Count  
20 are liable pursuant to Section 20(a) of the Exchange Act, jointly and severally with, and to the  
21 same extent as the Company is liable under Section 10(b) of the Exchange Act and Rule 10b-5  
22 promulgated thereunder, to Plaintiffs and the other members of the Class who purchased or  
23 otherwise acquired WaMu securities. Moreover, as detailed above, during the respective times  
24 these Defendants served as officers of WaMu, each of these Defendants is culpable for the  
25 material misstatements and omissions made by WaMu, including such misstatements in the  
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1 Company press releases, Forms 10-K, Forms 10-Q, Offering Documents and Registration  
2 Statements.

3 794. As a direct and proximate result of these Defendants' conduct, Plaintiffs and the  
4 other members of the Class suffered damages in connection with their purchase or acquisition of  
5 WaMu securities.

6  
7 **THIRD CLAIM FOR RELIEF**

8 **For Violations of Section 20(a) of The Exchange Act**  
9 **(Against Audit Committee and Finance Committee Defendants)**

10 795. Plaintiffs repeat and re-allege each and every allegation contained above as if  
11 fully set forth herein.

12 796. This Count is asserted against the Audit Committee and Finance Committee for  
13 violations of Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of all members of  
14 the Class.

15 797. During their tenure as directors of WaMu, each of these Defendants was a  
16 controlling person of WaMu within the meaning of Section 20(a) of the Exchange Act. By  
17 reason of their positions of control and authority as directors and Finance Committee members  
18 and/or Audit Committee members of WaMu, these Defendants had the power and authority to  
19 cause WaMu to engage in the wrongful conduct complained of herein. These Defendants were  
20 able to and did control, directly and indirectly, the content of the public statements made by  
21 WaMu during the Class Period, thereby causing the dissemination of the false and misleading  
22 statements and omissions of material facts as alleged herein.

23  
24 798. WaMu maintains both an Audit Committee and a Finance Committee, each  
25 composed of certain Board members, that reports to WaMu's full Board of Directors. As detailed  
26 in Section IV above, at some time during the Class Period, Defendants Frank, Leppert, Lillis,  
27

Matthews, Murphy, Reed and Smith (the “Audit Committee Defendants”) each participated as a member of the Audit Committee. As detailed in Section IV above, at some time during the Class Period, Defendants Farrell, Frank, Montoya, Murphy, Osmer-McQuade, Pugh, Reed and Smith (the “Finance Committee Defendants”) each participated as a member of the Finance Committee.

799. According to WaMu’s Forms 10-K for 2006 and 2007, the “Board of Directors, assisted by the Audit and Finance Committees on certain delegated matters, oversees the Company’s monitoring and controlling of significant risk exposures, including the Company’s policies governing risk management.”

800. As set forth below, each of these Defendants had the power to control and/or influence the particular practices and conduct giving rise to the securities violations alleged herein, and exercised the same. In their capacities as directors of WaMu, during their tenure these Defendants each signed certain of the Company’s filings, including the Company’s Forms 10-K for the years ended December 31, 2005 through December 31, 2006, the Offering Documents (as defined below in ¶816) and/or the Registration Statements (as defined below in ¶816), and therefore had the power and authority to control the statements made in such filings. As a result, these Defendants, as a group and individually, were controlling persons within the meaning of Section 20(a) of the Exchange Act.

### **The Audit Committee**

801. According to WaMu’s Proxy Statements for 2005 through 2008, the Audit Committee performed the following functions: (1) assisted with the oversight of the integrity of the Company’s financial reporting process and financial statements and systems of internal controls; (2) assisted with the oversight of the Company’s compliance with legal and regulatory requirements; (3) selected and retained the independent auditor, and reviewed its qualifications,

1 independence and performance; (4) selected the general auditor, and assisted with the oversight  
2 of the performance of the Company's internal audit function; and, (5) approved and monitored  
3 the administration of policies addressing management of operational risk.

4 802. According to the Audit Committee Charter available on the Company's website,  
5 the Audit Committee shall meet with management and the independent auditor to review and  
6 discuss the quarterly report on Form 10-Q and the annual report on Form 10K, including:  
7

8 the Company's disclosure under "Management's Discussion and Analysis of  
9 Financial Condition and Results of Operations," the annual financial statements  
10 and the report of the independent auditor thereon, and significant issues  
11 encountered in the course of the audit work, including: restrictions on the scope of  
12 activities; recommended adjustments arising from the audit; ***the adequacy of  
internal controls over financial reporting, including any special steps adopted  
in response to any significant deficiencies or material weaknesses in the design  
or operation of internal controls over financial reporting*** identified during the  
13 course of the annual audit and the adequacy of disclosures about changes in  
14 internal controls over financial reporting; access to required information; the  
15 adequacy of the disclosure of off-balance sheet transactions, arrangements,  
16 ***obligations and relationships in reports filed with the SEC***; and the  
17 appropriateness of the presentation of any pro forma financial information  
18 included in any report filed with the SEC.

19 803. In addition, the Audit Committee Charter states that with regard to legal  
20 compliance/enterprise risk, the Committee shall, among other things:  
21

22 Consult with the Company's chief legal officer and chief enterprise risk officer  
23 concerning legal and regulatory matters that may have a significant impact on the  
24 Company's financial statements, compliance policies or programs[.] . . .

25 Have such meetings with management as the Committee deems appropriate to  
26 discuss significant risk exposures facing the Company and to discuss the steps  
27 that management has taken to monitor and control such exposures, including the  
28 Company's guidelines and policies governing risk assessment and risk  
management.

804. According to WaMu's Forms 10-K for 2005 through 2007, the Audit Committee  
also approves the Operational Risk Management Policy which "establishes the Company's  
operational risk framework and defines the roles and responsibilities for the management of  
operational risk."



1 805. As a result of their positions as Audit Committee members, over and above their  
2 positions as Board members, each of the Audit Committee Defendants is liable as a control  
3 person of WaMu within the meaning of Section 20(a) of the Exchange Act.

4 **The Finance Committee**

5 806. According to WaMu's Proxy Statements for 2005 through 2008, the Finance  
6 Committee performed the following functions: (1) monitored investments and dispositions of  
7 loans and financial instruments, and significant purchases and dispositions of real property  
8 acquired by the Company (excluding the Company's premises or other real property acquired for  
9 use by the Company); (2) approved and monitored the administration of policies addressing the  
10 Company's allocation of capital and the Company's management of market and credit risk; (3)  
11 monitored the development and implementation of strategies that guide the Company's financial  
12 management activities; and, (4) reviewed and made recommendations with respect to the  
13 payment of dividends, the issuance and repurchase of equity, and the issuance and retirement of  
14 debt.

15 807. WaMu's Finance Committee Charter, available on the Company's website, further  
16 describes the duties of the Committee as including among other things, the duty to:

17  
18 Monitor the development and implementation of strategies that guide the  
19 Company's financial management activities, including capital, funds, liquidity,  
20 interest rate risk and credit risk management[.] . . .

21 Monitor aspects of financial activities of the Company's key subsidiaries that are  
22 material to the Company's business and its return on its investment in these  
23 subsidiaries.

24 808. WaMu's Forms 10-K for 2005 through 2007 state that the Finance Committee has  
25 oversight over the framework for the Company's credit risk management activities. In fact, in its  
26 2006 Form 10-K WaMu states that "[i]n 2006, the Finance Committee...approved a set of credit  
27

1 risk concentration limits.” In addition, the Finance Committee oversees the administration of the  
2 Company policy on asset/liability management.

3 809. According to a March 27, 2008 shareholder letter by the CtW Investment Group  
4 (“CtW”), CtW met with members of the WaMu Board and senior management in early 2008  
5 prior to the Company’s April 15 Annual Meeting. CtW states that Company representatives:

6  
7 pointed out that Finance Committee meetings had been restructured in 2005 to  
8 increase focus on matters of significant concern and reduce time devoted to  
9 routine matters; ***that the Committee had been receiving reports on the housing***  
10 ***market regularly since 2005***; that management had incorporated an assumption of  
11 zero house price appreciation for 2006 and 2007; ***and that the Committee had***  
12 ***heard from outside experts, such as BlackRock, Standard & Poors, and***  
13 ***Goldman Sachs, on various matters, including mortgage servicing rights and***  
14 ***credit losses.***

15 810. In response to the CtW letter, WaMu filed a Schedule 14A on April 3, 2008 stating  
16 that ***“our entire board are and have been actively engaged in formulating and overseeing***  
17 ***management’s implementation of risk management policies.”*** In addition, the Company  
18 outlined the steps it had taken to mitigate risk since 2004, including increased diversification into  
19 retail banking and credit card business, the selling of subprime mortgage channel volume and  
20 Option ARM home loans, the selling of mortgage servicing rights and “tightening subprime  
21 underwriting standards....”

22 811. As a result of their positions as Finance Committee members, over and above  
23 their positions as Board members, each of the Finance Committee Defendants is liable as a  
24 control person of WaMu within the meaning of Section 20(a) of the Exchange Act.

25 812. By reason of their positions as directors of WaMu, and more specifically as  
26 members of the Audit Committee and/or the Finance Committee, each of the Audit Committee  
27 and Finance Committee is a “controlling person” within the meaning of Section 20(a) of the  
28 Exchange Act and had the power and influence to direct the management and activities of the

1 Company and its employees, and to cause the Company to engage in the unlawful conduct  
2 complained of herein. Because of their positions, these Defendants had access to adverse non-  
3 public financial information about the Company including, among others things, its risk  
4 management and acted to conceal the same, or knowingly or recklessly authorized and approved  
5 the concealment of the same.

6  
7 813. As set forth above, WaMu violated Section 10(b) of the Exchange Act by its acts  
8 and omissions alleged in this Complaint. By virtue of their positions as controlling persons of  
9 WaMu and as a result of their own aforementioned conduct, the Audit Committee and Finance  
10 Committee are liable pursuant to Section 20(a) of the Exchange Act, jointly and severally with,  
11 and to the same extent as the Company is liable under Section 10(b) of the Exchange Act and  
12 Rule 10b-5 promulgated thereunder, to Plaintiffs and the other members of the Class who  
13 purchased or otherwise acquired WaMu securities. Moreover, as detailed above, during the  
14 respective times these Defendants served as directors of WaMu, each of these Defendants is  
15 culpable for the material misstatements and omissions made by WaMu, including such  
16 misstatements in the Company press releases, Forms 10-K, Forms 10-Q, the Offering Documents  
17 and Registration Statement.

18  
19 814. As a direct and proximate result of these Defendants' conduct, Plaintiffs and the  
20 other members of the Class suffered damages in connection with their purchase or acquisition of  
21 WaMu securities.

#### 22 23 **XIV. CLAIMS BROUGHT PURSUANT TO THE SECURITIES ACT**

24 815. In the allegations and claims set forth in this part of the Complaint, Plaintiffs  
25 assert a series of strict liability and negligence claims based on the Securities Act on behalf of the  
26 Class (as defined in ¶51 above, except that Plaintiffs explicitly disclaim subpart [g] of ¶56 from  
27

these Securities Act allegations). Plaintiffs' Securities Act claims are not based on any allegations of knowing or reckless misconduct on behalf of the Defendants named in the Fourth through Sixth Claims for Relief. Plaintiffs' Securities Act claims do not allege, and do not sound in, fraud, and Plaintiffs specifically disclaim any reference to or reliance upon allegations of fraud in these non-fraud claims under the Securities Act. To avoid an (unfounded) argument by Defendants that the claims below somehow "sound in fraud," it is necessary to state or summarize facts also stated above.

816. This action was brought within one year after the discovery of the untrue statements and omissions (and within one year after such discovery should have been made in the exercise of reasonable diligence) and within three years after each of the four offerings described herein.

817. Specifically, the Securities Act Defendants (set forth below) conducted four securities offerings on behalf of WaMu during the Class Period (referred to collectively as the "Offerings"), through which the Company raised approximately **\$4.8 billion**. The Offerings were conducted pursuant to a prospectus and shelf registration statement, filed with the SEC on Form S-3AR on January 9, 2006 (the "Registration Statement"). As set forth in the Registration Statement, the Company could issue debt securities, preferred stock, and depositary shares through the issuance of a prospectus supplement without filing a new registration statement for each offering. The Offerings at issue are as follows:

- The August 2006 Offering: On or about August 24, 2006, WaMu conducted a public offering of approximately **\$900 million** of notes, including \$500 million of floating rate notes due August 24, 2009 (the "Floating Rate Notes") and \$400 million 5.50% notes due August 24, 2011 (the "5.50% Notes"). The August 2006

Offering was marketed and sold to the public through the materially false Registration Statement and prospectus supplements dated August 21, 2006, and filed with the SEC on Forms 424B2 on August 21, 2006 and August 22, 2006, respectively, and on Form 424B5 on August 23, 2006 (the “August 2006 Prospectus,” together with the Registration Statement, the “August 2006 Offering Documents”). In connection with this Offering, WaMu raised approximately \$897.85 million before expenses.

- The September 2006 Offering: On or about September 18, 2006, WaMu conducted a public offering of 20,000,000 depositary shares, with each depositary share representing 1/40,000<sup>th</sup> interest in a share of Series K perpetual non-cumulative floating rate preferred stock (defined above as the “Series K Stock”) for a maximum aggregate offering price of **\$500 million**. The September 2006 Offering was marketed and sold to the public through the materially false Registration Statement and prospectus supplements dated September 11, 2006, and filed with the SEC on Form 424B2 and Form 424B5 on September 11, 2006 and September 13, 2006, respectively, (the “September 2006 Prospectus,” together with the Registration Statement, the “September 2006 Offering Documents”). The Series K Stock is listed on the NYSE under the symbol “Wm PrK.” In connection with this public Offering, WaMu raised approximately \$495.5 million before expenses.
- The October 2007 Offering: On or about October 25, 2007, WaMu announced a public offering of **\$500 million** of 7.250% subordinated notes due November 1, 2017 (defined above as the “7.250% Notes”). The October 2007 Offering was

1 marketed and sold to the public through the materially false Registration  
2 Statement and prospectus supplements dated October 25, 2007, and filed with the  
3 SEC on Form 424B2 and Form 424B5 on October 25, 2007 and October 29,  
4 2007, respectively, (the “October 2007 Prospectus,” together with the Registration  
5 Statement, the “October 2007 Offering Documents”). In connection with this  
6 Offering, WaMu raised approximately \$494.39 million before expenses.

- 7  
8 • The December 2007 Offering: On or about December 17, 2007, WaMu  
9 conducted a public offering of 3,000,000 shares of 7.75% Series R Non-  
10 Cumulative Perpetual Convertible Preferred Stock (the “Series R Stock”), for a  
11 maximum aggregate offering amount of **\$3.0 billion**. The December 2007  
12 Offering was marketed and sold to the public through the materially false  
13 Registration Statement and prospectus supplements dated December 10, 2007 and  
14 December 11, 2007, and filed with the SEC on Form 424B5 on December 11,  
15 2007 and December 13, 2007 (the “December 2007 Prospectus,” together with the  
16 Registration Statement, the “December 2007 Offering Documents”). The Series  
17 R Stock is listed on the NYSE under the symbol “Wm PrR.” In connection with  
18 this Offering, WaMu raised approximately \$2.9 billion after expenses.

19  
20  
21 The Registration Statement, the August 2006 Offering Documents, the September 2006 Offering  
22 Documents, the October 2007 Offering Documents, and the December 2007 Offering  
23 Documents are collectively referred to herein as the “Offering Documents.”

24 818. As discussed in more detail below, the Offering Documents contained untrue  
25 statements of material fact and omitted to state material facts required to be stated therein or  
26 necessary to make the statements therein not misleading.

**A. Securities Act Defendants**

819. The Securities Act claims are asserted against the Company, all signatories to the Offering Documents, all members of WaMu's Board of Directors at the time of the filing of the materially untrue Offering Documents, the Underwriter Defendants (defined below), Deloitte & Touche LLP ("Deloitte"), WaMu's outside auditor during the Class Period, and those officers who were controlling persons of WaMu. Each of these Defendants is statutorily liable under Sections 11, 12 and/or 15 of the Securities Act for the materially untrue statements contained in WaMu's Offering Documents, including WaMu's materially false and misleading financial statements incorporated therein.

**1. The Washington Mutual Defendants**

820. Washington Mutual: As set forth above in ¶¶15-20, at all relevant times hereto, WaMu had four primary operating segments: the Home Loans Group, the Retail Banking Group, the Card Services Group and the Commercial Group. The functions and operations of the Company's Home Loans and Retail Banking Groups are explained above at ¶¶17-19. WaMu was the issuer of the Floating Rate Notes, the 5.50% Notes, the Series K Stock, the 7.250% Notes, and the Series R Stock offered pursuant to the Offerings.

821. Kerry K. Killinger: As set forth above in ¶21, Killinger has served as the Company's Chief Executive Officer since 1990 and as a member of the Company's Board since 1998, including as Chairman of the Board from 1991 until June 30, 2008. Killinger signed the Company's Registration Statement, which was then incorporated into each of the Offering Documents. Killinger was also a member of the Board at the time of the filing of the August 2006 Offering Documents, the September 2006 Offering Documents, the October 2007 Offering Documents, and the December 2007 Offering Documents.

1           822. Thomas W. Casey: As set forth above in ¶22, Casey has served as Executive Vice  
2 President and Chief Financial Officer of WaMu since October 2002. Casey signed the  
3 Company's Registration Statement, which was then incorporated into each of the Offering  
4 Documents.

5           823. John F. Woods: As set forth above in ¶27, Woods served as Senior Vice President  
6 and Controller for Washington Mutual from December 2005 until mid-2007. Woods signed the  
7 Company's Registration Statement, which was then incorporated into each of the Offering  
8 Documents.

9           824. Melissa J. Ballenger: As set forth above in ¶28, Ballenger served as Senior Vice  
10 President and Assistant Controller and later as Controller at WaMu. Ballenger signed the  
11 Company's Forms 10-Q for the quarters ended March 31, 2007 and June 30, 2007 which were  
12 incorporated by reference into the October 2007 Offering Documents and the December 2007  
13 Offering Documents. Ballenger also signed the Company's Form 10-Q for the quarter ended  
14 September 30, 2007 which was incorporated into the December 2007 Offering Documents.

15           825. Anne V. Farrell: As set forth above in ¶30, Farrell served as a director of the  
16 Company from 1994 through April 2008. Farrell signed the Company's Registration Statement  
17 which was then incorporated into each of the Offering Documents. Farrell was also a member of  
18 the Board at the time of the filing of the August 2006 Offering Documents, the September 2006  
19 Offering Documents, the October 2007 Offering Documents and the December 2007 Offering  
20 Documents.

21           826. Stephen E. Frank: As set forth above in ¶31, Frank has served as a director of  
22 Company since 1997, and since July 1, 2008, Chairman of the Board. Frank signed the  
23 Company's Registration Statement which was then incorporated into each of the Offering  
24 Documents.



1 Documents. Frank was also a member of the Board at the time of the filing of the August 2006  
2 Offering Documents, the September 2006 Offering Documents, the October 2007 Offering  
3 Documents and the December 2007 Offering Documents.

4 827. Thomas C. Leppert: As set forth above in ¶32, Leppert has served as a director of  
5 the Company since September 2005. Leppert signed the Company's Registration Statement  
6 which was then incorporated into each of the Offering Documents. Leppert was also a member  
7 of the Board at the time of the filing of the August 2006 Offering Documents, the September  
8 2006 Offering Documents, the October 2007 Offering Documents and the December 2007  
9 Offering Documents.

10 828. Charles M. Lillis: As set forth above in ¶33, Lillis has served as a director of the  
11 Company since June 2005. Lillis signed the Company's Registration Statement which was then  
12 incorporated into each of the Offering Documents. Lillis was also a member of the Board at the  
13 time of the filing of the August 2006 Offering Documents, the September 2006 Offering  
14 Documents, the October 2007 Offering Documents and the December 2007 Offering Documents.

15 829. Phillip D. Matthews: As set forth above in ¶34, Matthews has served as a director  
16 of the Company since 1998. Matthews signed the Company's Registration Statement which was  
17 then incorporated into each of the Offering Documents. Matthews was also a member of the  
18 Board at the time of the filing of the August 2006 Offering Documents, the September 2006  
19 Offering Documents, the October 2007 Offering Documents and the December 2007 Offering  
20 Documents.

21 830. Regina Montoya: As set forth above in ¶35, Montoya has served as a director of  
22 the Company since April 2006. Montoya was a member of the Board at the time of the filing of  
23 the August 2006 Prospectus, the September 2006 Prospectus, the October 2007 Prospectus and  
24

1 the December 2007 Prospectus. Montoya also signed the Company's Form 10-K for the year  
2 ended December 31, 2006, which was expressly incorporated by reference into the October 2007  
3 Offering Documents and the December 2007 Offering Documents.

4 831. Michael K. Murphy: As set forth above in ¶36, Murphy has served as a director  
5 of the Company since 1985. Murphy signed the Company's Registration Statement which was  
6 then incorporated into each of the Offering Documents. Murphy was also a member of the  
7 Board at the time of the filing of the August 2006 Offering Documents, the September 2006  
8 Offering Documents, the October 2007 Offering Documents and the December 2007 Offering  
9 Documents.

10 832. Margaret Osmer-McQuade: As set forth above in ¶37, Osmer-McQuade has  
11 served as a director of the Company since 2002. Osmer-McQuade signed the Company's  
12 Registration Statement which was then incorporated into each of the Offering Documents.  
13 Osmer-McQuade was also a member of the Board at the time of the filing of the August 2006  
14 Offering Documents, the September 2006 Offering Documents, the October 2007 Offering  
15 Documents and the December 2007 Offering Documents.

16 833. Mary E. Pugh: As set forth above in ¶38, Pugh served as a director of WaMu  
17 from 1999 until April 2008. Pugh signed the Company's Registration Statement which was then  
18 incorporated into each of the Offering Documents. Pugh was also a member of the Board at the  
19 time of the filing of the August 2006 Offering Documents, the September 2006 Offering  
20 Documents, the October 2007 Offering Documents and the December 2007 Offering Documents.

21 834. William G. Reed, Jr.: As set forth above in ¶39, Reed has served as a director of  
22 the Company since 1970. Reed signed the Company's Registration Statement which was then  
23 incorporated into each of the Offering Documents. Reed was also a member of the Board at the  
24

1 time of the filing of the August 2006 Offering Documents, the September 2006 Offering  
2 Documents, the October 2007 Offering Documents and the December 2007 Offering Documents.

3 835. Orin C. Smith: As set forth above in ¶40, Smith has served as a director of the  
4 Company since July 2005. Smith signed the Company's Registration Statement which was then  
5 incorporated into each of the Offering Documents. Reed was also a member of the Board at the  
6 time of the filing of the August 2006 Offering Documents, the September 2006 Offering  
7 Documents, the October 2007 Offering Documents and the December 2007 Offering Documents.

8 836. James H. Stever: Stever has served as a director of the Company since 1991.  
9 Stever signed the Company's Registration Statement, which was then incorporated into each of  
10 the Offering Documents. Stever was also a member of the Board at the time of the filing of the  
11 August 2006 Offering Documents, the September 2006 Offering Documents, the October 2007  
12 Offering Documents and the December 2007 Offering Documents.

13 837. Willis B. Wood, Jr.: Wood served as a director of the Company from 1997  
14 through April of 2006. Wood signed the Company's Registration Statement, which was then  
15 incorporated into each of the Offering Documents. Willis also signed the 2005 Form 10-K,  
16 which was incorporated into the August Offering Documents and the September Offering  
17 Documents.

## 20 2. The Auditor Defendant

21 838. Deloitte has served as WaMu's outside auditor since at least 1997. Deloitte issued  
22 unqualified opinions on the Company's financial statements and management's assessment of  
23 internal controls throughout the Class Period and, of particular relevance to the Securities Act  
24 claims, for the full years 2005 and 2006. On January 3, 2006, Deloitte consented to the  
25 incorporation by reference in the Registration Statement of its auditor report dated March 7, 2005  
26  
27

1 relating to WaMu's consolidated financial statements for the year ended December 31, 2004.  
2 Moreover, Deloitte consented to the incorporation by reference into the August 2006 Prospectus  
3 and the September 2006 Prospectus of its unqualified auditor's report, dated March 8, 2006, for  
4 the year ended December 31, 2005. Specifically, under the caption "Experts" in each of these  
5 Prospectuses, WaMu stated that the financial statements set forth in the 2005 Form 10-K were  
6 "incorporated herein by reference, and have been so incorporated in reliance upon the reports of  
7 such firm given upon their authority as experts in accounting and auditing." Similarly, Deloitte  
8 consented to the incorporation by reference into the October 2007 Prospectus and the December  
9 2007 Prospectus of its unqualified auditor's report, dated February 26, 2007, for the year ended  
10 December 31, 2006. In each of these Prospectuses, WaMu stated that the financial statements set  
11 forth in the 2006 Form 10-K were "incorporated herein by reference, and have been so  
12 incorporated in reliance upon the reports of such firm given upon their authority as experts in  
13 accounting and auditing." Deloitte maintains its national headquarters at 1633 Broadway, New  
14 York, New York 10019.  
15  
16

### 17 3. The Underwriter Defendants

18 839. Goldman, Sachs & Co. ("Goldman Sachs") is an investment bank and acted as  
19 underwriter and joint book-running manager for the August 2006 Offering, underwriter and joint  
20 bookrunner for the September 2006 Offering, and underwriter and joint book-running manager  
21 for the December 2007 Offering. Pursuant to the Offering Documents, Goldman Sachs sold and  
22 distributed \$176 million of the 5.50% Notes, \$220 million of the Floating Rate Notes, 3,700,000  
23 shares of the Series K Stock, and 300,000 shares of the Series R Stock to the investing public.  
24 Goldman Sachs was paid at least \$10.2 million for its underwriting services in connection with  
25  
26  
27

1 the Offerings. Goldman Sachs' headquarters are located at 85 Broad Street, New York, New  
2 York 10004.

3 840. Morgan Stanley & Co. Incorporated ("Morgan Stanley") is an investment bank  
4 and acted as underwriter and joint book-running manager for the August 2006 Offering,  
5 underwriter and joint bookrunner for the September 2006 Offering, underwriter and joint book-  
6 running manager for the October 2007 Offering, and underwriter and joint book-running  
7 manager for the December 2007 Offering. Pursuant to the Offering Documents, Morgan Stanley  
8 sold and distributed \$176 million of the 5.50% notes, \$220 million of the Floating Rate Notes,  
9 \$112.5 million of the Notes, 3,700,000 shares of the Series K Stock, and 990,000 shares of the  
10 Series R Stock to the investing public. Morgan Stanley was paid at least \$31.2 million for its  
11 underwriting services in connection with the Offerings. Morgan Stanley's headquarters are  
12 located at 1585 Broadway, New York, New York 10036.  
13  
14

15 841. Credit Suisse Securities (USA) LLC ("Credit Suisse") is an investment bank and  
16 acted as underwriter and joint book-running manager for the August 2006 Offering, underwriter  
17 and co-manager for the September 2006 Offering, underwriter and joint book-running manager  
18 for the October 2007 Offering, and underwriter and joint book-running manager for the  
19 December 2007 Offering. Pursuant to the Offering Documents, Credit Suisse sold and  
20 distributed \$16 million of the 5.50% Notes, \$20 million of the Floating Rate Notes, \$112.5  
21 million of the 7.250% Notes, 500,000 shares of the Series K Stock, and 300,000 shares of the  
22 Series R Stock to the investing public. Credit Suisse was paid at least \$9.4 million for its  
23 underwriting services in connection with the Offerings. Credit Suisse's headquarters are located  
24 at 11 Madison Avenue, New York, New York 10010.  
25  
26  
27

1           842. Deutsche Bank Securities Inc. (“Deutsche Bank”) is an investment bank and acted  
2 as underwriter and joint book-running manager for the August 2006 Offering and underwriter for  
3 the December 2007 Offering. Pursuant to the Offering Documents, Deutsche Bank sold and  
4 distributed \$16 million of the 5.50% Notes, \$20 million of the Floating Rate Notes, and 60,000  
5 shares of the Series R Stock to the investing public. Deutsche Bank was paid at least \$1.8  
6 million for its underwriting services in connection with the Offerings. Deutsche Bank’s United  
7 States headquarters are located at 60 Wall Street, New York, New York 10005.

8  
9           843. Lehman Brothers Inc. (“Lehman Brothers”) is an investment bank and acted as  
10 underwriter and joint book-running manager for the August 2006 Offering, underwriter and joint  
11 bookrunner for the September 2006 Offering, underwriter and joint book-running manager for  
12 the October 2007 Offering, and underwriter and joint book-running manager for the December  
13 2007 Offering. Pursuant to the Offering Documents, Lehman Brothers sold and distributed \$16  
14 million of the 5.50% Notes, \$20 million of the Floating Rate Notes, \$112.5 million of the  
15 7.250% Notes, 3,700,000 shares of the Series K Stock, and 990,000 shares of the Series R Stock  
16 to the investing public. Lehman Brothers was paid at least \$30.8 million for its underwriting  
17 services in connection with the Offerings. Lehman Brothers’ headquarters are located at 745  
18 Seventh Avenue, New York, New York 10019.

19  
20           844. UBS Securities LLC (“UBS”) is an investment bank and acted as underwriter,  
21 sole structuring advisor and joint bookrunner for the September 2006 Offering and underwriter  
22 for the December 2007 Offering. Pursuant to the Offering Documents, UBS sold and distributed  
23 7,400,000 shares of the Series K Stock and 60,000 shares of the Series R Stock to the investing  
24 public. UBS was paid at least \$3.2 million for its underwriting services in connection with the  
25  
26  
27

1 Offerings. UBS' United States headquarters are located at 677 Washington Boulevard, Stamford,  
2 Connecticut 06901.

3 845. Banc of America Securities LLC ("Banc of America") is an investment bank and  
4 acted as underwriter and co-manager for the September 2006 Offering. Pursuant to the Offering  
5 Documents, Banc of America sold and distributed 500,000 shares of the Series K Stock to the  
6 investing public. Banc of America was paid at least \$100,000 for its underwriting services in  
7 connection with the September 2006 Offering. Banc of America's headquarters are located at 9  
8 West 57th Street, New York, New York 10019.

10 846. J.P. Morgan Securities Inc. ("J.P. Morgan") is an investment bank and acted as  
11 underwriter and co-manager for the September 2006 Offering and underwriter for the December  
12 2007 Offering. Pursuant to the Offering Documents, J.P. Morgan sold and distributed 500,000  
13 shares of the Series K Stock and 60,000 shares of the Series R Stock to the investing public. J.P.  
14 Morgan was paid at least \$1.9 million for its underwriting services in connection with the  
15 Offerings. J.P. Morgan's headquarters are located at 270 Park Avenue, New York, New York  
16 10017.

18 847. Barclays Capital Inc. ("Barclays") is an investment bank and acted as underwriter  
19 and joint book-running manager for the October 2007 Offering and underwriter for the  
20 December 2007 Offering. Pursuant to the Offering Documents, Barclays sold and distributed  
21 \$112.5 million of the 7.250% Notes and 60,000 shares of the Series R Stock to the investing  
22 public. Barclays was paid at least \$2.1 million for its underwriting services in connection with  
23 the October 2007 Offering. Barclays' United States headquarters are located at 200 Park Avenue,  
24 New York, New York 10166.

1       848. Keefe, Bruyette & Woods, Inc. (“Keefe, Bruyette”) is an investment bank and  
2 acted as underwriter and co-manager for the October 2007 Offering and underwriter for the  
3 December 2007 Offering. Pursuant to the Offering Documents, Keefe, Bruyette sold and  
4 distributed \$25 million of the 7.250% Notes of Washington Mutual and 12,000 shares of the  
5 Series R Stock to the investing public. Keefe, Bruyette was paid at least \$435,000 for its  
6 underwriting services in connection with the Offerings. Keefe, Bruyette’s headquarters are  
7 located at 787 7th Avenue, New York, New York 10019.  
8

9       849. Cabrera Capital Markets, LLC (“Cabrera Capital”) is an investment bank and  
10 acted as underwriter and co-manager for the October 2007 Offering and underwriter for the  
11 December 2007 Offering. Pursuant to the Offering Documents, Cabrera Capital sold and  
12 distributed \$12.5 million of the 7.250% Notes and 12,000 shares of the Series R Stock to the  
13 investing public. Cabrera Capital was paid at least \$397,500 for its underwriting services in  
14 connection with the Offerings. Cabrera Capital’s headquarters are located at 10 South La Salle  
15 Street, Suite 1050, Chicago, Illinois 60603.  
16

17       850. The Williams Capital Group, L.P. (“Williams Capital”) is an investment bank and  
18 acted as underwriter and co-manager for the October 2007 Offering and underwriter for the  
19 December 2007 Offering. Pursuant to the Offering Documents, Williams Capital sold and  
20 distributed \$12.5 million of the 7.250% Notes and 12,000 shares of the Series R Stock to the  
21 investing public. Williams Capital was paid at least \$397,500 for its underwriting services in  
22 connection with the Offerings. Williams Capital’s headquarters are located at 650 Fifth Avenue,  
23 11th Floor, New York, New York 100019.  
24

25       851. Citigroup Global Markets, Inc. (“Citigroup”) is an investment bank and acted as  
26 underwriter for the December 2007 Offering. Pursuant to the Offering Documents, Citigroup  
27



1 sold and distributed 60,000 shares of the Series R Stock to the investing public. Citigroup was  
2 paid at least \$1.8 million for its underwriting services in connection with the December 2007  
3 Offering. Citigroup's headquarters are located at 388 Greenwich St., New York, NY 10013.

4 852. Greenwich Capital Markets, Inc. ("Greenwich"), also referred to as RBS  
5 Greenwich Capital in the December 2007 Offering Documents, acted as an underwriter for the  
6 December 2007 Offering. Greenwich sold and distributed 60,000 shares of the Series R Stock to  
7 the investing public. Greenwich was paid at least \$1.8 million for its underwriting services in  
8 connection with the December 2007 Offering. Greenwich's headquarters are located at 1101  
9 30th Street, NW, Suite 500, Washington, DC 20007.

10 853. BNY Capital Markets, Inc. ("BNY") is an investment bank and acted as  
11 underwriter for the December 2007 Offering. Pursuant to the Offering Documents, BNY sold  
12 and distributed 12,000 shares of the Series R Stock to the investing public. BNY was paid at  
13 least \$1.8 million for its underwriting services in connection with the December 2007 Offering.  
14 BNY's headquarters are located at One Wall Street, 18th Floor, New York, NY 10286.

15 854. Samuel A. Ramirez & Company, Inc. ("Ramirez & Co.") is an investment bank  
16 and acted as underwriter for the December 2007 Offering. Pursuant to the Offering Documents,  
17 Ramirez & Co. sold and distributed 12,000 shares of the Series R Stock to the investing public.  
18 Ramirez & Co. was paid at least \$360,000 for its underwriting services in connection with the  
19 December 2007 Offering. Ramirez & Co.'s headquarters are located at 61 Broadway, 29th Floor,  
20 New York, N.Y. 10006.

## 21 **B. Background**

22 855. WaMu provided financing to homeowners in the form of home mortgages and  
23 "second-lien" products such as home equity loans and home equity lines of credit. These loans  
24

1 were either held by WaMu for investment (“in portfolio”) or sold to investors in whole loan sales  
2 or securitizations.

3 856. The quality of the loans originated by WaMu, and in particular the risk level of  
4 WaMu’s loans, was crucial to determining, among other things, the value of the loans on the  
5 Company’s balance sheet and the extent of the loss exposure facing the Company for such loans.  
6 The Company was required under generally accepted accounting principles (defined above as  
7 “GAAP”) to evaluate on a regular basis the quality of the loans in its portfolio as part of the  
8 financial statement preparation process. If the Company determined that the loans were impaired  
9 for any reason, including because of credit risk, it was required to increase, or “provision,” its  
10 Allowance for Loan and Lease Losses (defined above as the “Allowance”) as a reserve against  
11 incurred and probable future losses inherent in the Company’s loans held in portfolio. However,  
12 as set forth below, WaMu failed to properly provision against the Company’s incurred and  
13 probable losses because it did not take into account the Company’s ineffective risk management,  
14 unreliable appraisal practices, high-risk loan products, and deteriorating underwriting practices.  
15

16 857. Indeed, in 2005, the Company embarked on a systemic change in practices and  
17 policies whereby WaMu emphasized growing loan volume (and thus profits) over loan quality  
18 and balanced, prudent growth. This change was manifested in several ways, including: (1)  
19 relegating the Company’s risk management efforts to focus on supporting the loan production  
20 staff, rather than acting as a gatekeeper for loan quality and a protector against loan losses; (2)  
21 forcing both in-house and third-party appraisers to inflate appraisal values; (3) originating greater  
22 volumes of exotic and high-risk loans and; (4) loosening the Company’s underwriting standards.  
23 As explained below in greater detail, each of these actions was taken to allow WaMu to close  
24 ever-greater volumes of loans and to make the Company appear more profitable than it was.  
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1           858. As a result of WaMu's drive towards growth, the risks inherent the Company's  
2 loan portfolio were dramatically heightened. However, as discussed below, the Company did not  
3 provision the Allowance at the levels necessary to match these heightened risks. This failure  
4 resulted in the Company's financial statements being materially misstated. In particular, since  
5 provisions for the Company's Allowance reduce the Company's pre-tax income on a dollar-for-  
6 dollar basis, the Company's failure to properly provision its Allowance caused the Company's  
7 net income and earnings per share to be overstated. As set forth below, the misstatement of these  
8 financial results was material.

10                           **1. WaMu Curbs Risk Management Efforts**  
11                           **in Furtherance of Increasing Loan**  
12                           **Volume**

13           859. Effective risk management efforts were necessary to ensure that the Company  
14 originated loans that were not susceptible to a high degree of losses. However, the Company  
15 relegated its risk management personnel to a secondary "support" role to loan production, rather  
16 than as a primary safeguard against unsafe lending that would cause the Company to incur  
17 greater losses. By doing so, WaMu removed controls against extremely risky lending practices.  
18 Moreover, rather than have risk management personnel report directly to the Board of Directors  
19 or an independent executive officer, WaMu placed Defendant Schneider in charge of *both* the  
20 Company's Home Loans' risk management operations and the Company's Home Loans' lending  
21 operations (*i.e.*, sales).

22           860. Additionally, the Company's ineffective risk management approach allowed  
23 management to misuse the Loan Performance Risk Model (defined above as the "LPRM"), the  
24 key model used by the Company to predict losses, and thus provided the main input as to the  
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appropriate manner in which to provision the Allowance. The LPRM used by WaMu during the Class Period failed to accurately predict losses in at least two important ways.

861. First, as indicated by an internal report entitled “Corporate Risk Oversight Report: Allowance of Loan & Lease Losses Methodology of Washington Mutual Bank” (defined above as the “CRO Report”) and dated September 2005, the LPRM did not appropriately analyze for risk of losses in the Company’s Option ARM loans, or other loans with the potential for “negative amortization.” By way of background, WaMu’s Option ARM loans allowed the borrower to choose to pay less than the total accrued interest and principal on a loan each month. If the borrower chose a lesser payment, then the difference between the lesser payment and the total due would be added to the principal balance of the loan, thus “negatively amortizing.” This had a material impact on the Company’s evaluation of risk for losses on its loans, because Option ARM loans comprised over half the Company’s prime loan portfolio, and, due to the optional payment structure, were high-risk loan products.

862. Second, according to Confidential Witness 78, as of summer 2007, the LPRM had not been calibrated to reflect actual loan performance data for over *eighteen months*. This had the material effect that, in modeling for losses on its loans, the Company was not taking into account the actual deterioration that the Company’s loan portfolio experienced over the course of 2006 and 2007, which, as a result of the Company’s appraisal and underwriting practices, was significant during this time.

## **2. The Company Caused Appraisal Values for its Loans to be Inflated**

863. Beginning in 2005, the Company pressured its in-house appraisers to inflate the home loan values for loan applications submitted to the Company. In mid-2006, the Company started outsourcing its appraisals to two supposedly independent third-party appraisal companies,

1 First American Corporation through its subsidiary, eAppraiseIT, and Lenders Services Inc.  
2 (defined above as “LSI”). Despite this change to using third-party appraisers, the Company  
3 continued to exert pressure to inflate appraisal values.

4 864. These inflated appraisals allowed the Company to claim lower loan-to-value  
5 (defined above as “LTV”) ratios; *i.e.*, the loan amount was lower relative to the appraised value  
6 of the collateral for the loan. This also had the effect of creating the illusion that the  
7 homeowner’s equity in the collateral was greater. Generally, the greater the homeowner’s equity,  
8 the lower the risk associated with that loan. Conversely, the lower the homeowner’s equity, the  
9 higher the risk associated with that loan. Thus, the value of the appraisal in the loan file is  
10 critical to determining the LTV ratio and the associated risk of default in the loan.  
11

12 865. In its Form 10-K for 2006 and, in substantially similar language in its Form 10-K  
13 for 2005, WaMu acknowledged that the lower the equity a homeowner has in his or her home,  
14 the greater the risk of the borrower:  
15

16 Home equity loans and lines of credit with combined loan-to-value ratios of  
17 greater than 80 percent also expose the Company to greater credit risk than home  
18 loans with loan-to-value ratios of 80 percent or less at origination. This greater  
19 credit risk arises because, in general, both default risk and the severity of risk is  
20 higher when borrowers have less equity in their homes.

21 866. WaMu also acknowledged that it used LTV ratios to determine the default risk of  
22 loans held in portfolio. Because loans with high LTV ratios carry a greater risk of  
23 nonperformance, the Company must provision at higher rates for the Allowance.

24 867. Former WaMu and eAppraiseIT employees confirm WaMu’s improper appraisal  
25 practices. Indeed, as former appraisers of WaMu have reported, inflation of appraisal values was  
26 commonplace at WaMu beginning in 2005. CW 24, a former WaMu employee who spent four  
27 years working as a Senior Appraisal Coordinator, recalled that starting in 2005, WaMu began to

1 significantly increase pressure on appraisers to exaggerate appraisal values. Specifically, as a  
2 Senior Appraisal Coordinator, CW 24 served as a liaison between WaMu loan officer/brokers  
3 (*i.e.*, loan production staff) and WaMu appraisers and, in this position, received regular  
4 complaints from both in-house and outside appraisers about WaMu requiring “a certain value” to  
5 make loans “work.” Indeed, CW 24 explained that the push by WaMu to inflate appraisals was a  
6 constant problem throughout the Class Period.  
7

8 868. Similarly, CW 25, who was a loan consultant at Washington Mutual Home Loans  
9 in Maryland from September 2003 until November 2005, recalled that when a WaMu loan  
10 officer brought in a loan application, typically the WaMu loan officer was able to request a  
11 specific appraiser. CW 25 explained that in the event that a loan officer was provided an  
12 appraisal value that the loan officer found unacceptable, the loan officer could request a  
13 “reconsideration of value” (defined above as “ROV”) in which the loan officer could provide a  
14 different set of comparables to a WaMu “master appraiser” to reevaluate the loan. CW 25 stated  
15 that WaMu loan officers regularly put a great deal of pressure on the loan coordinators and  
16 demanded that initial appraisal values be reevaluated if unacceptable to them.  
17

18 869. CW 25 recalled that, at WaMu, in-house appraisers received kickbacks from loan  
19 consultants to “hit” value on appraisals. Despite CW 25’s complaints to management about the  
20 appraisal process at WaMu, WaMu management did nothing to change the situation. Indeed, CW  
21 25’s job was threatened on many occasions in response to CW 25’s complaints of appraisal  
22 corruption.  
23

24 870. CW 31 who was a contract appraiser with eAppraiseIT after leaving WaMu as an  
25 in-house appraiser, also confirmed that WaMu pressured appraisers to inflate appraisal values.  
26 Specifically, CW 31 stated that WaMu dictated appraisal values that it needed to satisfy the LTV  
27

1 ratios it desired. CW 31 explained that WaMu pressured the third-party appraisers by (i)  
2 badgering them to meet the Company's desired appraisal values, and (ii) ceasing to hire  
3 appraisers who did not bring in the inflated appraisal value that WaMu desired.

4 871. WaMu's improper appraisal practices have been further confirmed by New York  
5 State Attorney General Andrew Cuomo. Specifically, on November 1, 2007, Attorney General  
6 Cuomo filed a complaint against First American Corporation and eAppraiseIT (defined above as  
7 the "NYAG Complaint"), which details how WaMu pressured appraisers to inflate appraisal  
8 values. The NYAG Complaint was filed after "investigators had spent nine months interviewing  
9 hundreds of mortgage industry executives and poring over millions of documents obtained  
10 through subpoenas," according to a November 2, 2007 *New York Times* article.

11 872. Indeed, the NYAG Complaint alleges, on the basis of numerous internal emails,  
12 including emails between WaMu and eAppraiseIT, that WaMu executives pressured eAppraiseIT  
13 to increase the appraised value of homes and that eAppraiseIT improperly allowed WaMu's loan  
14 production staff to hand-pick appraisers who brought in appraisal values high enough to permit  
15 WaMu's loans to close. Additionally, the NYAG Complaint alleges that WaMu repeatedly  
16 pressured eAppraiseIT appraisers to change appraisal values that were too low to permit loans to  
17 close.

18 873. As with eAppraiseIT, WaMu also inflated appraisal values through LSI another  
19 purportedly independent appraisal service company. For example, according to CW 39, a  
20 member of LSI's appraisal team management for WaMu from August 2006 through February  
21 2007, LSI was forced to give priority to appraisers from a WaMu "preferred appraisal" list for its  
22 appraisals. CW 39, recalled that WaMu often pressured LSI appraisers to raise appraisal values  
23  
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26  
27

1 by frequently submitting ROVs by contacting appraisers directly, and by WaMu loan officers  
2 requesting to work with specific appraisers because “they knew each other.”

3 874. According to CW 39, the practice of WaMu loan officers contacting LSI  
4 appraisers directly, which CW 39 described as “illegal,” occurred frequently. CW 39 also  
5 believed that WaMu’s efforts to dictate which specific LSI appraisers should be used for WaMu  
6 loans was “illegal.” According to CW 39, LSI acknowledged the impropriety of the practice, but  
7 re-construed it as a “recommendation” from WaMu.  
8

9 875. Indeed, WaMu’s appraisal practices were inconsistent with Federal Regulations  
10 and guidelines that govern such conduct. In fact, on March 22, 2005, federal regulators –  
11 including the OTS, which regulates WaMu – published guidance directly applicable to WaMu on  
12 appraisals, entitled “Frequently Asked Questions on the Appraisal Regulations and the  
13 Interagency Statement on Independent Appraisal and Evaluation Functions” (defined above as  
14 the “2005 Interagency Appraisal Guidelines”). The 2005 Interagency Appraisal Guidelines,  
15 which apply to “all real-estate-related financial transactions” mandate, among other things, that:  
16

- 17 • Loan production staff should not select appraisers.
- 18 • Loan production staff should not be involved in developing or  
19 maintaining lists of appraisers, and that any such list of appraisers  
20 should be the subject of periodic evaluation to maintain  
21 independence.  
22
- 23 • Upon engaging an appraisal, “information provided by the  
24 regulated institution should not unduly influence the appraiser or in  
25 any way suggest the property’s value.”  
26  
27



- Prior to making a final credit decision, “regulated institutions should perform a compliance review on all appraisals to confirm that they comply with the minimum appraisal standards. . . .”

Thus, WaMu’s appraisal practices did not conform with the governing regulations and guidelines.

876. WaMu’s practice of inducing appraisers, both in-house and third-party appraisers, to overvalue the real estate underlying WaMu loans caused an increased and material risk of loss for loans held in the Company’s portfolio.

### **3. WaMu Adopted Deficient Underwriting Standards**

877. Throughout the Class Period, WaMu further increased the Company’s loss exposure and the poor quality of the loans held in the Company’s portfolio by loosening its underwriting standards in order to close more loans. Contrary to WaMu’s statements in its SEC filings, discussed below, the Company instituted extremely loose underwriting guidelines for increasingly risky loan products and routinely allowed exceptions to those already-loosened standards to generate greater loan volume. Further, WaMu incentivized its salespeople, underwriters, and management to close a higher volume of loans, with increased bonuses for the more exotic, high-risk loans without any regard for the quality of the loans originated.

878. Numerous former WaMu employees describe how, during the Class Period, WaMu was focused on generating ever-increasing volumes of high-risk loans, repeatedly stressed quantity without regard to quality, and abandoned prudent underwriting practices to accomplish these goals. For example, Confidential Witness 2, who worked at WaMu from 1995 until 2008, most recently as an Underwriting Supervisor from 2005 until 2008, explained that no exception to WaMu’s underwriting guidelines was needed for many risky loans, because WaMu’s

1 “guidelines were so generous.” Moreover, CW 2 further added that for those loans that did not  
2 fit within the loose guidelines of WaMu’s underwriting standards, exceptions to WaMu’s already-  
3 loose guidelines were always readily available. Additionally, Confidential Witness 51, a Senior  
4 Underwriter at the WaMu home loan center in Lake Success, New York from 2007 to 2008,  
5 agreed that guideline exceptions were “part of the norm . . . it was so commonplace to go outside  
6 of the guidelines.” Even when exceptions were sent to management for approval, CW 51  
7 observed that the exceptions “were always approved, so it was just business as usual and  
8 something that they were comfortable with.”

10 879. Confidential Witness 52, an underwriting Team Manager with WaMu from 2004  
11 through 2007, estimated that exceptions to the underwriting guidelines occurred 30-40% of the  
12 time. According to CW 52, the types of exceptions “varied so much” from “accepting certain  
13 income documentation – or lack thereof – to credit score exceptions . . . there [were] tons of  
14 exceptions.”

16 880. Confidential Witness 66, a Senior Underwriter at WaMu’s subprime-lending  
17 subsidiary, Long Beach Mortgage (defined above as “LBM”) from 2004 through September  
18 2007 explained that LBM also utilized loose and exception-ridden underwriting guidelines. CW  
19 66 stated that there were significant flaws in the LBM’s underwriting procedures and described  
20 the culture of LBM as “just do it.” Indeed, CW 66 explained, “There were really no restrictions  
21 to approve a loan,” and some “really bad loans” went through the office. The attitude at WaMu  
22 was “push, push, push.”

24 881. WaMu’s lenient lending environment was particularly dangerous in underwriting  
25 for the Company’s high-risk Option ARM and Alt-A loans. As mentioned above, Option ARM  
26 loans are adjustable-rate mortgage loans that give the borrower the option each month to make a  
27

1 fully-amortizing, interest-only or minimum payment, and to amortize any unpaid interest onto  
2 the principal of the loan. WaMu offered a low “teaser” rate for an introductory period of the  
3 loan, which automatically adjusted to a much higher rate, known as the “fully-indexed” rate,  
4 after a set period of time, or after a certain amount of unpaid interest had been amortized onto the  
5 principal. Contrary to its repeated public representations, the Company underwrote these loans  
6 to the “teaser” rate rather than the fully-indexed rate, greatly increasing the chance that once the  
7 loan payments were required at the fully-indexed rate, the loans would default.

8  
9 882. Confidential Witness 62, a senior underwriter at WaMu’s Lake Success, New  
10 York office from June 2005 until February 2008, confirmed that during the Class Period, WaMu  
11 underwrote Option ARM loans to the teaser rate, rather than the fully-indexed rate.

12  
13 883. Indeed, a document published by WaMu’s loan securitization channel entitled  
14 “Mortgage Securities Corp. Seller Guide Update – Announcement Concerning Qualifying Rate  
15 and Qualifying Payment for Hybrid ARM, IO, and Option ARM Products” confirms that WaMu  
16 had been allowing Option ARM loans to be underwritten to their “teaser” rate until August 2007.

17  
18 884. Further, WaMu compensated its employees, including its underwriters, based on  
19 the number of loans that the employees closed, without regard to the quality of those loans.  
20 According to Confidential Witness 5, who served as Senior Credit Quality Manager from March  
21 2005 until February 2008, after having served as a WaMu Senior Underwriter from 2003 through  
22 2004, underwriters received large bonuses based upon the number of loans they had  
23 underwritten. According to CW 5, underwriters were required to underwrite a minimum of nine  
24 loans a day, and any loans underwritten in excess of that number provided for bonus payments.  
25 Indeed, certain senior underwriters earned in excess of \$100,000 annually because of these  
26 bonuses.

885. In fact, according to Confidential Witness 47, a long-time employee of WaMu who left after twenty-four years with the Company, WaMu was so focused on incenting underwriters to close a greater volume of loans that loan delinquency data was not provided to underwriters. According to CW 47, WaMu's senior management believed that if underwriters knew which underwriting problems led to greater delinquencies and defaults, WaMu's underwriters would "by nature" tighten up WaMu's lending standards.

#### 4. The Company's Financial Results Were Not Stated in Compliance With GAAP

886. The Company failed to properly account for the material increases in risk associated with its lending practices. As set forth above, during the Class Period, WaMu had, among other things, (1) discontinued effective risk management practices; (2) pressured its appraisers to inflate the appraisal values for the collateral underlying its loans; (3) significantly loosened its underwriting guidelines, (4) encouraged wholesale exceptions to those guidelines through explicit emphasis on loan quantity over quality; and (5) compensated its employees based upon loan volume without regard to loan quality. By not taking these high-risk practices into consideration when accounting for the Company's incurred and probable loan losses, WaMu violated GAAP.

887. Specifically, the Company violated Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (defined above as "SFAS 5"). SFAS 5, a fundamental GAAP principle which was issued over thirty years ago, states that:

An estimated loss for loss contingency . . . shall be accrued by a charge to income if *both* of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It

1 is implicit in this condition that it must be probable that one or  
2 more future events will occur confirming the fact of the loss.

3 b. The amount of loss can be reasonably estimated.

4 (Emphasis in original.)

5 888. The SEC provides further guidance on the proper accounting for credit risk and  
6 loan losses. SEC Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance  
7 Methodology and Documentation Issues" (a defined above as "SAB 102"), which was issued in  
8 July 2001, states in pertinent part: "It is critical that loan loss allowance methodologies  
9 incorporate management's current judgments about the credit quality of the loan portfolio  
10 through a disciplined and consistently applied process . . . . A registrant's loan loss allowance  
11 methodology generally should . . . [c]onsider all known relevant internal and external factors that  
12 may affect loan collectability . . . [and] be based on current and reliable data[.]"

13  
14 889. In violation of GAAP and SEC guidelines, WaMu failed to take into account the  
15 undisclosed, poor quality, and high-risk nature of the Company's loan portfolio as well as all  
16 known internal factors that would affect loan collectability, including the Company's dubious  
17 underwriting and appraisal activities, when provisioning its Allowance.

18  
19 890. Indeed, an internal document obtained through Lead Plaintiff's investigation  
20 shows that until as late as June 30, 2006, and possibly later, the Company had no method for  
21 determining the losses inherent in its Option ARM loans and thus appropriately provisioning for  
22 such losses. Specifically, the CRO Report explicitly states that the Company's fundamental  
23 model for evaluating losses, known as the "LPRM" "is untested on products with the potential to  
24 negatively amortize." Because Option ARM loans constituted well over half the Company's loan  
25 portfolio during the Class Period and, because of their structure, are high-risk products, this  
26  
27

1 failure to account for negative amortization had enormous negative impact on the Company's  
2 financial statements.

3 891. Further, WaMu, through the LPRM, did not account for deteriorating loan  
4 performance during the Class Period at all. As Confidential Witness 78 reported, in the summer  
5 of 2007, a WaMu analyst who worked in calibrating the LPRM to calculate losses inherent in  
6 WaMu's loan portfolio, and thus how much to provision the Allowance, informed CW 78 that the  
7 LPRM had not been calibrated to reflect actual loan performance for eighteen months. Defaults,  
8 delinquencies, and foreclosures, all of which rose steadily during the Class Period, were thus not  
9 considered at all when provisioning the Allowance.  
10

11 892. These failures to account for negative amortization and for deteriorating loan  
12 performance exacerbated the already deficient and improper accounting for the Company's loan  
13 portfolio. Defendants' improper risk management, underwriting, and appraisal practices during  
14 the Class Period (1) caused the Company's Allowance and loan loss provisions to be materially  
15 understated during the Class Period; (2) caused WaMu to report financial results that were in  
16 violation of GAAP; (3) caused certain of the Company's reported financial information,  
17 including net income, earnings per share and assets to be materially overstated throughout the  
18 Class Period; and (4) rendered Defendants' statements about the adequacy of the Company's  
19 internal controls, incorporated by reference into the Offering Materials, materially false and  
20 misleading.  
21  
22

## 23 **5. Deloitte Failed to Audit WaMu in** 24 **Accordance with GAAS**

25 893. In addition to WaMu's false representations regarding the Company's compliance  
26 with GAAP, Deloitte also falsely represented that the Company's financial results were presented  
27 in compliance with GAAP. Specifically, in certifying WaMu's 2005 and 2006 financial  
28

statements, Deloitte falsely represented that those financial statements were prepared in accordance with GAAP and that Deloitte's audits were conducted in accordance with Generally Accepted Auditing Standards ("GAAS").<sup>7</sup> When an auditor represents that a company's financial statements conform in all material respects with GAAP, the auditor "indicates [his] belief that the financial statements taken as a whole are not materially misstated." AU § 312.<sup>8</sup> Indeed, "[f]inancial statements are materially misstated when they contain misstatements whose effect, individually or in the aggregate, is important enough to cause them not to be presented fairly, in all material respects, in conformity with [GAAP]." AU § 312.

894. Deloitte's statements were untrue because its audits did not conform to GAAS and, therefore, Deloitte had no reasonable basis to represent that WaMu's financial statements fairly presented the Company's financial position and results of operations in conformity with GAAP. In issuing unqualified audit opinions on WaMu's financial statements, Deloitte failed to comply with the professional standards dictated by GAAS.

895. GAAS General Standard No. 3 requires an auditor to exercise due professional care in the performance of the audit and preparation of the report. (AU § 150.01). Deloitte violated General Standard No. 3 by, among other things, disregarding (i) the improper pressure

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<sup>7</sup> The Public Company Accounting Oversight Board ("PCAOB"), established by the Sarbanes-Oxley Act of 2002, is responsible for the development of auditing and related professional practice standards that are required to be followed by registered public accounting firms. On April 16, 2003, the PCAOB adopted as its interim standards GAAS as described by the AICPA Auditing Standards Board's SAS No. 95, *Generally Accepted Auditing Standards*, and related interpretations in existence on that date. Accordingly, an auditor's reference to "the standards of the Public Accounting Oversight Board (United States)" includes a reference to GAAS in existence as of April 16, 2003. All references to GAAS hereinafter include the standards of the PCAOB.

<sup>8</sup> GAAS includes Statements on Auditing Standards ("SAS") issued by the Auditing Standards Board of the American Institute of Certified Public Accountants ("AICPA"), which are codified in *AICPA Professional Standards* under the prefix "AU."

1 WaMu exerted on its in-house and third party appraisers to inflate appraisal values to close more  
2 loans; (ii) the Company's abandonment of, and deviation from, its underwriting guidelines to  
3 originate ever-increasing volumes of loans; and (iii) the Company's relegation of its credit risk  
4 management to a secondary role, all of which reduced the quality of loans in WaMu's portfolio,  
5 significantly increased WaMu's loss exposure and necessitated the establishment of a much  
6 higher Allowance and provisions for loan losses. Had Deloitte complied with GAAS, the only  
7 reasonable professional conclusion it could have drawn was that the Company's Allowance and  
8 provisions for loan losses were insufficient and, consequently, the Company had overstated its  
9 net income, earnings per share, and the value of its assets in violation of GAAP.  
10

11 896. GAAS Standard of Fieldwork No. 1 requires an auditor to plan the audit, which  
12 "involves developing an overall strategy for the expected conduct and scope of the audit." AU  
13 § 311.03. This requires understanding the entity's business sufficiently to identify areas of risk.  
14 AU §311.06. Deloitte violated Standard of Fieldwork No. 1 by, among other things, failing to  
15 plan and conduct an audit that would include identifying and assessing WaMu's areas of risk,  
16 specifically, the quality of its loan originations and lending practices, and the performance of its  
17 loans, including rates of delinquencies and foreclosures and levels of nonperforming assets and  
18 negative amortization. Had Deloitte complied with GAAS, the only reasonable professional  
19 conclusion it could have drawn was that the Company was originating high-risk loans in  
20 violation of its underwriting guidelines, that the Company was inflating appraisal values, and  
21 that those loans were frequently and increasingly experiencing increasing rates of delinquencies,  
22 and foreclosures. Deloitte would have also uncovered that WaMu was experiencing increasing  
23 levels of nonperforming assets and negative amortization.  
24  
25  
26  
27



1 897. GAAS Standard of Fieldwork No. 2 requires that an auditor have a sufficient  
2 understanding of the company's internal controls to properly plan the audit, assess audit risk, and  
3 to determine the nature, timing and extent of the tests performed. Further, while it is  
4 management's responsibility to establish and maintain internal controls, AU § 110.03, the  
5 independent auditor is responsible for rendering an opinion on management's assessment of the  
6 effectiveness of the company's internal control over financial reporting. PCAOB Auditing  
7 Standards ("AS") No. 2, An Audit of Internal Control Over Financial Reporting Performed in  
8 Conjunction with an Audit of the Financial Statements, ¶4.

10 898. Deloitte violated Standard of Fieldwork No. 2 and the requirements of AS No. 2  
11 by disregarding the fact that WaMu routinely violated its underwriting guidelines and pressured  
12 appraisers to inflate appraisal values. GAAS, specifically, the AICPA Audit & Accounting Guide  
13 for Depository and Lending Institutions, Ch. 8, ¶132 required that Deloitte review loan  
14 origination files to determine the Company's compliance with those guidelines. In addition,  
15 Deloitte violated Standard of Fieldwork No. 2 because it disregarded that WaMu's loss modeling  
16 methodology did not (i) appropriately analyze and capture the risk of losses in the Company's  
17 Option ARM loans or other loans with the potential to negatively amortize and (ii) take into  
18 account the actual deterioration that was experienced in the Company's loan portfolio during the  
19 course of 2006 and 2007. Had Deloitte complied with GAAS, the only reasonable professional  
20 conclusion it could have drawn was that WaMu's internal controls over financial reporting were  
21 so ineffective that the Company's financial statements were not fairly presented in accordance  
22 with GAAP.

25 899. GAAS Standards of Fieldwork Nos. 2 and 3 require that an independent auditor  
26 obtain, through inspection, observation, inquiries and confirmations, competent, sufficient  
27

1 evidential matter to afford a reasonable basis for its opinion. AU § 150.02. Deloitte violated  
2 Standard of Fieldwork Nos. 2 and 3 by, among other things, failing to obtain evidence that  
3 WaMu had adequately provisioned for its substantial loss exposure that resulted from the  
4 Company's improper underwriting and appraisal practices and ineffective risk management. Had  
5 Deloitte complied with GAAS, the only reasonable professional conclusion it could have drawn  
6 was that WaMu's reported Allowance and provisions were insufficient and that the Company had  
7 failed to account for the high-risk, low-quality loans it issued, in violation of GAAP.  
8

9 900. GAAS also requires an auditor to evaluate "the reasonableness of accounting  
10 estimates made by management in the context of the financial statements taken as a whole," AU  
11 § 342.04, thus requiring Deloitte to review the assumptions and estimates concerning, among  
12 other things, the risks of default, delinquency and foreclosure attendant to WaMu's high-risk loan  
13 originations. Deloitte violated this duty by, among other things, disregarding WaMu's failure to  
14 take into account its aggressive origination practices and accompanying increase in the  
15 Company's risk of default, delinquency and foreclosures. Had Deloitte complied with GAAS,  
16 the only reasonable professional conclusion it could have reached was that the estimates  
17 underlying WaMu's accounting were unreasonable.  
18

19 901. Standard of Reporting No. 4 requires an auditor to express an opinion on the  
20 financial statements of a company taken as a whole, or an assertion to the extent that an opinion  
21 cannot be expressed. AU § 150.02. As a result of Deloitte's violations of GAAS set forth above,  
22 it also violated the Standard of Reporting No. 4 because Deloitte had an insufficient basis to  
23 express an unqualified opinion on its 2005 and 2006 audits of WaMu. Accordingly, as set forth  
24 below, Deloitte's public statements concerning those audits were untrue, and contained  
25 omissions of material facts.  
26  
27

**C. The August 2006 Offering and the September 2006 Offering**

902. On or about August 24 2006, WaMu conducted the August 2006 Offering, consisting of the Floating Rate Notes and the 5.50% Notes. The Company raised \$897.85 million in capital from this offering, which it used for general corporate purposes, including providing funding to its subsidiaries and repurchasing shares of the Company's stock.

903. The August 2006 Offering was conducted pursuant to the August 2006 Offering Documents, which incorporated by express reference several of WaMu's public filings, including its Form 10-K/A for the fiscal year ended December 31, 2005 (the "2005 Form 10-K"), which was audited by Deloitte and certified as being in conformance with GAAP, and its Forms 10-Q for the quarters ended March 31, 2006 (the "First Quarter 2006 Form 10-Q") and June 30, 2006 (the "Second Quarter 2006 Form 10-Q"). The 2005 Form 10-K was signed by Defendants Killinger, Casey, Farrell, Woods, Frank, Pugh, Leppert, Reed, Lillis, Smith, Matthews, Stever, Murphy, Wood, and Osmer-McQuade. The un-amended First Quarter 2006 Form 10-Q and the Second Quarter 2006 Form 10-Q were signed by Defendants Casey and Woods. The Form 10-Q/A for the first quarter 2006 was signed by Defendant Casey alone.

904. As noted above, Goldman Sachs, Morgan Stanley, Credit Suisse, Deutsche Bank, and Lehman Brothers served as joint book-running managers for the August 2006 Offering.

905. Additionally, on or about September 18, 2006, WaMu conducted the September 2006 Offering of the Series K Stock. The Company raised \$495.5 million in capital from this offering, which it used for general corporate purposes, including, among other things, repurchasing shares of the Company's stock.

906. The September 2006 Offering was conducted pursuant to the September 2006 Offering Documents, which incorporated by express reference several of WaMu's filings made

1 after the date of the Registration Statement pursuant to Sections 13(a), 13(c), 14, or 15(d),  
2 including its 2005 Form 10-K, which was audited by Deloitte and certified as being in  
3 conformance with GAAP, and its First Quarter 2006 Form 10-Q and Second Quarter 2006 Form  
4 10-Q.

5  
6 907. As noted above, UBS, Goldman Sachs, Lehman Brothers, and Morgan Stanley  
7 served as joint book-running managers for the September 2006 Offering. Banc of America,  
8 Credit Suisse, and J.P. Morgan served as co-managers for the September 2006 Offering.

9  
10 908. WaMu made numerous material misstatements and omissions in the August 2006  
11 Offering Documents and the September 2006 Offering Documents regarding its financial results,  
12 compliance with GAAP, credit risk management, and underwriting and appraisal practices.  
13 These statements misinformed investors in the August 2006 and September 2006 Offerings  
14 regarding the soundness of the Company's evaluation of the risk of its loan portfolios, which had  
15 grave implications for the reliability of its financial statements, and rendered the August 2006  
16 Offering Documents and the September 2006 Offering Documents materially untrue and  
17 misleading.

18  
19 **1. The August 2006 Offering Documents and**  
20 **September 2006 Offering Documents**  
**Misstated the Company's Lending**  
**Practices**

21 909. To start, the August 2006 Offering Documents and September 2006 Offering  
22 Documents misstated the Company's lending practices. Specifically, with regard to the  
23 Company's underwriting of loans, the 2005 Form 10-K stated that, "[t]he Company seeks to  
24 mitigate the credit risk in this portfolio by ensuring compliance with underwriting standards on  
25 loans originated to subprime borrowers and by re-underwriting all purchased subprime loans."  
26 The 2005 Form 10-K further represented that: "The Company actively manages the credit risk  
27

1 inherent in its Option ARM portfolio primarily by ensuring compliance with its underwriting  
2 standards, monitoring loan performance and conducting risk modeling procedures.”

3 910. In addition, in discussing its lending operations in the 2005 Form 10-K, WaMu  
4 repeatedly stated that LTV ratios were a “key determinant of future performance,” stating:

5 Loan-to-value ratios are a key determinant of future performance. Home loans  
6 with loan-to-value ratios of greater than 80 percent at origination without private  
7 mortgage insurance or government guarantees expose the Company to greater  
8 credit risk than home loans with loan-to-value ratios of 80 percent or less at  
9 origination. . . . This greater credit risk arises because, in general, both default  
10 risk and the severity of loss is higher when borrowers have less equity to protect  
11 in the event of foreclosure.

12 911. The Company’s statements in the 2005 Form 10-K, which were incorporated into  
13 the August 2006 Offering Documents and the September 2006 Offering Documents, regarding its  
14 risk management, underwriting, and appraisal practices were materially false and misleading  
15 because the Company was, in fact, lowering its underwriting standards and issuing loans that  
16 were increasingly unlikely to be repaid. The Company did not comply with its underwriting  
17 standards and underwrote high-risk loans to borrowers who were not able to repay such loans  
18 and made exceptions to its underwriting guidelines as a matter of course. Indeed, the Company  
19 omitted from the August 2006 Offering Documents and the September 2006 Offering Documents  
20 the key facts that, during the third quarter of 2005, the Company had loosened underwriting  
21 standards and increased its exceptions to those underwriting standards in order to increase loan  
22 volume. In addition, the Company did not adequately manage its risk. As set forth above,  
23 starting in 2005, WaMu relegated its risk management to a secondary “support” role. WaMu also  
24 had deficient risk management in that its loan loss modeling methodology did not appropriately  
25 analyze or capture the Company’s Option ARM loans and did not reflect the actual loan  
26 deterioration that the Company experienced during 2006.

1 912. Moreover, the statements in the Company's 2005 Form 10-K regarding its use of  
2 LTV ratios in its underwriting as "key determinants of future performance" were false and  
3 misleading because the Company was systematically inflating the appraisal values of the real  
4 estate collateral underlying its loans, which materially distorted the LTV ratios for the  
5 Company's home loans. Thus, the LTV ratios that the Company relied on were misstated and, as  
6 such, were not accurate "determinants of future performance." Moreover, the Company failed to  
7 disclose its widespread practice of pressuring appraisers, both in-house appraisers and third party  
8 appraisers, to overstate appraisal values so that the Company could close more loans. The  
9 omission of the Company's improper appraisal practices from the August 2006 Offering  
10 Documents and the September 2006 Offering Documents rendered these Offering Documents  
11 materially misleading.  
12

13  
14 **2. The August 2006 Offering Documents and**  
15 **September 2006 Offering Documents**  
16 **Contained Untrue Financial Results**

17 913. The August 2006 Offering Documents and September 2006 Offering Documents  
18 also contained materially misstated financial results for WaMu for 2005 and the first half of  
19 2006. These included material understatements of the Company's Allowance and provision for  
20 loan losses and material overstatements of the Company's net income, earnings per share and  
21 assets that resulted directly from the Company's undisclosed lending practices and deterioration  
22 in the quality of the WaMu's loans.

23 914. In the 2005 Form 10-K, WaMu reported that for the full year 2005, the  
24 Company's reported net income was \$3.43 billion, or \$3.73 per diluted share. The Company  
25 also reported a full-year provision for loan and lease losses of \$316 million and total assets as of  
26 December 31, 2005, of \$343.6 billion.  
27

1           915. The August 2006 and September 2006 Offering Documents also incorporated by  
2 express reference the First Quarter 2006 Form 10-Q and Second Quarter 2006 Form 10-Q. The  
3 Company's First Quarter 2006 Form 10-Q reported net income of \$985 million, diluted earnings  
4 per common share of \$0.98, an Allowance of \$1.6 billion and assets of \$348.6 billion. The  
5 Company's Second Quarter 2006 Form 10-Q reported net income of \$767 million, diluted  
6 earnings per common share of \$0.79, an Allowance of \$1.7 billion, and assets of \$350.9 billion.  
7

8           916. In addition, the 2005 Form 10-K, the First Quarter 2006 Form 10-Q, and the  
9 Second Quarter 2006 Form 10-Q falsely certified that: "The Company's financial reporting and  
10 accounting policies conform to accounting principles generally accepted in the United States of  
11 America ('GAAP')."

12           917. These statements concerning the Company's financial results and compliance  
13 with GAAP were materially untrue and misleading. Specifically, the Company's reported  
14 financial results in the August 2006 Offering Documents and the September 2006 Offering  
15 Documents misrepresented the value of the Company's net income, earnings per share,  
16 Allowance, provision for loan and lease losses and assets because the Company failed to  
17 properly account for the increased risks of default that accompanied the Company's departure  
18 from its lending standards, including its improper appraisal and underwriting practices. The  
19 Company, in loosening its underwriting guidelines and inflating the value of the appraisals  
20 underlying its loan portfolio, materially understated its Allowance, and materially inflated the  
21 Company's reported earnings and net income.  
22

23           918. Further, the Company failed to disclose the material fact that well into 2006  
24 WaMu's key model for calculating the appropriate provisions for the Allowance, the LPRM, was  
25 not designed or able to account properly for losses on Option ARM loans, and thus the  
26  
27



1 Company's evaluation of incurred and probable loan losses was materially understated. WaMu  
2 also omitted from the August 2006 Offering Documents and the September 2006 Offering  
3 Documents the material fact that the LPRM did not take into account the ongoing deteriorating  
4 loan quality of the Company's loan portfolio in calculating incurred and probable losses.

5  
6 919. Thus, the Company's certification of these financial statements as being presented  
7 in conformity with GAAP was also false and misleading.

8 920. Deloitte, WaMu's auditor, also issued a materially untrue and misleading report in  
9 connection with the Company's 2005 financial statements. Specifically, Deloitte audited the  
10 Company's year-end 2005 financial statements contained in the 2005 Form 10-K and issued an  
11 unqualified auditor's report on WaMu's consolidated statement of financial condition as of  
12 December 31, 2005, and the related consolidated statements of income, stockholders' equity and  
13 comprehensive income, and of cash flows for the year ended December 31, 2005.

14  
15 921. Deloitte's auditor's report, dated March 8, 2006, stated in pertinent part:

16 We have audited the accompanying consolidated statements of financial condition  
17 of Washington Mutual, Inc. and subsidiaries (the "Company") as of December 31,  
18 2005 and 2004, and the related consolidated statements of income, stockholders'  
19 equity and comprehensive income, and of cash flows for each of the three years in  
20 the period ended December 31, 2005.

21 \* \* \*

22 In our opinion, such consolidated financial statements present fairly, in all  
23 material respects, the financial position of the Company as of December 31, 2005  
24 and 2004, and the results of its operations and its cash flows for each of the three  
25 years in the period ended December 31, 2005, in conformity with accounting  
26 principles generally accepted in the United States of America.

27 922. Deloitte's unqualified auditor's report was incorporated into the August 2006  
28 Offering Documents and September 2006 Offering Documents. Specifically, the August 2006  
Offering Documents and the September 2006 Offering Documents incorporated by reference



Deloitte's reports, stating that it was "so incorporated in reliance upon the report of [Deloitte] given upon their authority as experts in accounting and auditing."

923. Deloitte's unqualified auditor's report, as included in the 2005 Form 10-K, was materially untrue and misleading because, as explained above, the Company's consolidated financial statements did not fairly present the Company's financial condition and were not prepared in accordance with GAAP. Moreover, in certifying WaMu's 2005 financial statements, Deloitte falsely represented that its audits were conducted in accordance with GAAS.

**3. The August 2006 Offering Documents and  
September 2006 Offering Documents  
Contained Untrue Statements Regarding  
the Effectiveness of WaMu's Internal  
Controls**

924. The August 2006 Offering Documents and September 2006 Offering Documents also contained materially untrue and misleading statements regarding the effectiveness of WaMu's internal controls over financial reporting. Specifically, in the Company's 2005 Form 10-K, management reported on the effectiveness of WaMu's internal controls. In this report, which falsely concluded that the Company maintained effective internal controls over financial reporting, the Company stated:

Management assessed the effectiveness of the Company's internal control over financial reporting, including safeguarding of assets as of December 31, 2005. . . . Based on this assessment, management believes that, as of December 31, 2005, the Company maintained effective internal control over financial reporting, including safeguarding of assets.

925. The First Quarter 2006 Form 10-Q and the Second Quarter 2006 Form 10-Q also included materially untrue statements regarding the effectiveness of WaMu's internal controls. For example, in the First Quarter 2006 Form 10-Q, the Company falsely represented that WaMu maintained effective internal controls over financial reporting, stating:

1 Management reviews and evaluates the design and effectiveness of the  
2 Company's internal control over financial reporting on an ongoing basis, which  
3 may result in the discovery of deficiencies, some of which may be significant, and  
4 changes its internal control over financial reporting as needed to maintain their  
5 effectiveness, correcting any deficiencies, as needed, in order to ensure the  
6 continued effectiveness of the Company's internal controls. There have not been  
7 any changes in the Company's internal control over financial reporting during the  
8 first quarter of 2006 that have materially affected, or are reasonably likely to  
9 materially affect, the Company's internal control over financial reporting.

10 The Company made the same representation, using substantially similar language, in the Second  
11 Quarter 2006 Form 10-Q.

12 926. The Company's statements certifying WaMu's internal controls were false and  
13 misleading because the Company's extremely loose underwriting and its practice of artificially  
14 inflating appraisal values, demonstrate that the Company's internal controls were materially  
15 deficient. Contrary to these repeated internal control certifications, the Company was operating  
16 without adequate controls in place to ensure compliance with the Company's underwriting and  
17 appraisal standards. Further, WaMu was operating without policies and appropriate methodology  
18 in place to ensure the soundness of its valuation of its assets and its Allowance, which, as set  
19 forth above, was materially understated at the time of the August 2006 and September 2006  
20 Offerings and during the Class Period. These failures demonstrate serious deficiencies in the  
21 Company's internal controls and contributed to materially distorting the Company's reporting of  
22 financial data.

23 927. In addition, the 2005 Form 10-K also included an unqualified auditor's report by  
24 Defendant Deloitte opining on the effectiveness of WaMu's internal control over financial  
25 reporting. This report, dated March 8, 2006, stated as follows:

26 We have audited management's assessment, included in the accompanying  
27 Management's Report on Internal Control Over Financial Reporting, that  
28 Washington Mutual, Inc. and subsidiaries (the "Company") maintained effective  
internal control over financial reporting as of December 31, 2005, based on

criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. . . .

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”). . . . Our audit included obtaining an understanding of internal control over financial reporting, evaluating management’s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

\* \* \*

In our opinion, management’s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

928. Deloitte’s report on WaMu’s internal controls was likewise materially false and misleading. For the reasons explained herein, the Company’s internal controls were materially deficient.

#### **D. The October 2007 Offering**

929. On or about October 25, 2007, WaMu announced the October 2007 Offering, an Offering consisting of the 7.250% Notes. The Company raised \$494.39 million in capital from this Offering, which it used for general corporate purposes, including providing funding for subsidiaries.

930. The October 2007 Offering Documents incorporated by reference several of WaMu’s public filings, including its Form 10-K for the fiscal year ended December 31, 2006 (the “2006 Form 10-K”), which was audited by Deloitte and certified as in conformance with GAAP, and its Forms 10-Q for the quarters ended March 31, 2007 (the “First Quarter 2007 Form 10-Q”)

1 and June 30, 2007 (the “Second Quarter 2007 Form 10-Q”). The 2006 Form 10-K was signed by  
 2 Defendants Killinger, Casey, Farrell, Woods, Frank, Montoya, Pugh, Leppert, Reed, Lillis,  
 3 Smith, Matthews, Stever, Murphy, and Osmer-McQuade. The First Quarter 2007 Form 10-Q and  
 4 the Second Quarter 2007 Form 10-Q were signed by Defendants Casey and Ballenger.

5 931. As noted above, Barclays, Credit Suisse, Lehman Brothers, and Morgan Stanley  
 6 served as joint book-running managers for the October 2007 Offering. Keefe, Bruyette; Cabrera  
 7 Capital; and Williams Capital served as co-managers for the October 2007 Offering.

8 932. WaMu made numerous material misstatements and omissions in the October 2007  
 9 Documents regarding its financial results, compliance with GAAP, credit risk management, and  
 10 underwriting and appraisal practices. These statements misinformed investors in the October  
 11 2007 Offering regarding the soundness of the Company’s evaluation of the risk of its loan  
 12 portfolios, which had grave implications for the reliability of its financial statements., and  
 13 rendered the October 2007 Documents materially untrue and misleading.  
 14  
 15

16 **1. The October 2007 Offering Documents**  
 17 **Misstated the Company’s Lending**  
 18 **Practices**

19 933. In the 2006 Form 10-K, the Company again claimed to mitigate risk in its high-  
 20 risk Option ARM and subprime lending in substantially the same language used in the 2005  
 21 Form 10-K, discussed above in ¶¶909-910. Further, the Company went on to claim that,

22 In the underwriting of loans, one of many factors the Company considers when  
 23 deciding whether to approve or decline a loan is the applicant’s debt-to-income  
 24 ratio. The Company’s underwriting process for Option ARM loans has  
 25 historically involved calculating an applicant’s debt-to-income ratio using an  
 26 administratively set interest rate. Prior to 2004, the administratively set rate  
 27 approximated the then-prevailing fully-indexed rate. . . . The administratively set  
 28 rate was adjusted upward in October 2005 and, beginning in mid-December 2005,  
 was replaced with a fully-indexed rate that adjusts monthly for changes in the  
 index rate.

1           934.   Additionally, the 2006 Form 10-K again repeated the Company's claim that loan-  
2 to-value ratios were a "key determinant of future performance" that the Company used to predict  
3 losses, in substantially the same language as that used in the 2005 Form 10-K.

4           935.   The Company's statements in the 2006 Form 10-K, which were incorporated into  
5 the October 2007 Offering Documents, regarding its risk management, underwriting, and  
6 appraisal practices were materially false and misleading because the Company was, in fact,  
7 lowering its underwriting standards and issuing loans that were increasingly unlikely to be  
8 repaid. The Company did not comply with its underwriting standards and did not actively  
9 manage its risk. The Company underwrote high-risk loans to borrowers who were not able to  
10 repay such loans and made exceptions to its underwriting guidelines as a matter of course.  
11 Indeed, the Company omitted from the October 2007 Documents the key facts that, during the  
12 third quarter of 2005, the Company loosened underwriting standards and increased its exceptions  
13 to those underwriting standards in order to increase loan volume. In addition, the Company did  
14 not adequately manage its risk. As set forth above, starting in 2005, WaMu relegated its risk  
15 management to a secondary "support" role. WaMu also had deficient risk management in that its  
16 loan loss modeling methodology did not appropriately analyze or capture the Company's Option  
17 ARM loans and did not reflect the actual loan deterioration that the Company experienced during  
18 2006 and 2007.

19           936.   Moreover, the statements in the Company's 2006 Form 10-K regarding its use of  
20 LTV ratios in its underwriting as "key determinants of future performance" were false and  
21 misleading because the Company was systematically inflating the appraisal values of the real  
22 estate collateral underlying its loans, which materially distorted the LTV ratios for the  
23 Company's home loans. Thus, the LTV ratios that the Company relied on were misstated and, as  
24  
25  
26  
27

such, were not accurate “determinants of future performance.” Moreover, the Company failed to disclose its widespread practice of pressuring appraisers, both in-house appraisers and third party appraisers, to overstate appraisal values so that the Company could close more loans. The omission of the Company’s improper appraisal practices from the October 2007 Offering Documents rendered these Offering Documents materially misleading.

## 2. The October 2007 Offering Documents Contained Untrue Financial Results

937. As noted above, the October 2007 Offering Documents incorporated by reference the Company’s 2006 Form 10-K, as well as the First Quarter 2007 Form 10-Q and the Second Quarter 2007 Form 10-Q. The 2006 Form 10-K reported net income of \$3.56 billion, or \$3.64 per diluted share. In this filing, the Company also reported total assets as of December 31, 2006, of \$346.3 billion and that its provision for loan and lease losses for 2006 was \$816 million.

938. Further, as noted above, the October 2007 Offering Documents incorporated by reference the First Quarter 2007 Form 10-Q and the Second Quarter 2007 Form 10-Q. The Company’s First Quarter 2007 Form 10-Q reported assets of \$319.9 billion, net income of \$784 million, diluted earnings per common share of \$.86, and an Allowance of \$1.5 billion. The Company’s Second Quarter 2007 Form 10-Q reported assets of \$312.2 billion, net income of \$830 million, diluted earnings per common share of \$.92, and an Allowance of \$1.6 billion.

939. In addition, the 2006 Form 10-K, the First Quarter 2007 Form 10-Q, and the Second Quarter 2007 Form 10-Q each falsely certified the Company’s financial statements conformed with GAAP, in substantially the same language as that in ¶916 above.

940. In addition to the Company’s SEC filings it incorporated by reference into the October 2007 Offering Documents, the Company disclosed in the October 2007 Offering Prospectus that the Company’s financial condition was dramatically weakened for the quarter

1 ending September 30, 2007. The Company blamed its financial condition on several elements,  
2 including “adverse developments in the mortgage lending business (and in the housing market  
3 more generally) and related volatility and liquidity constraints in the capital markets since June  
4 30, 2007.”

5  
6 941. These statements concerning the Company’s financial results and compliance  
7 with GAAP were materially untrue and misleading. In reality, the Company’s reported financial  
8 results in the October 2007 Offering Documents misrepresented the value of the Company’s net  
9 income, earnings per share, Allowance, provision for loan and lease losses and assets because the  
10 Company failed to properly account for the increased risks of default that accompanied the  
11 Company’s departure from its lending standards, including its improper appraisal and  
12 underwriting practices. The Company, in loosening its underwriting guidelines and inflating the  
13 value of the appraisals underlying its loan portfolio, materially understated its Allowance and  
14 materially inflated the Company’s reported earnings and net income. Specifically, in 2006 the  
15 Company under-provisioned the Company’s Allowance by at least \$562 million, or over 40%.  
16 This GAAP violation had the effect of overstating the Company’s reported net income for full  
17 year 2006 by at least \$349 million, or 10%. The Company’s diluted earnings per share was  
18 overstated by at least \$0.35 for the full year 2006.  
19

20  
21 942. Further, for the first quarter of 2007, WaMu under-provisioned the Company’s  
22 loss reserves by at least \$398 million, or 63%, and overstated the Company’s reported net  
23 income by at least \$164 million, or 21%. The Company’s diluted earnings per share was  
24 overstated by at least \$0.18 for the first quarter 2007. In the second quarter 2007, WaMu under-  
25 provisioned the Company’s loss reserves by at least \$472 million, or 56%, and overstated the  
26  
27



1 Company's reported net income by at least \$265 million, or 32%. The Company's diluted  
2 earnings per share was overstated by at least \$0.30 for the second quarter 2007.

3 943. Further, the Company failed to disclose the material fact that well into 2006  
4 WaMu's key model for calculating the appropriate provisions for the Allowance, the LPRM, was  
5 not designed or able to account properly for losses on Option ARM loans, and thus the  
6 Company's evaluation of incurred and probable loan losses was materially understated. WaMu  
7 also omitted from the October 2007 Offering Documents the material fact that the LPRM did not  
8 take into account the ongoing deteriorating loan quality of the Company's loan portfolio in  
9 calculating incurred and probable losses.  
10

11 944. The Company's statements attributing its losses to a market-wide upheaval were  
12 also materially false and misleading. At no point in the October 2007 Offering Documents did  
13 the Company discuss how its deteriorated underwriting standards and its inflated appraisals  
14 undermined its financial condition, caused its losses, and caused its Allowance to be materially  
15 understated.  
16

17 945. Thus, the Company's certification of these financial statements as being presented  
18 in conformity with GAAP was also false and misleading.

19 946. Defendant Deloitte issued a materially untrue and misleading unqualified  
20 auditor's report, dated February 26, 2007, in connection with the Company's 2006 financial  
21 statements. This report, which was included in to the Company's 2006 Form 10-K and  
22 incorporated by reference in the October 2007 Offering Documents, contained the same or  
23 substantially similar language as that included in Defendant Deloitte's unqualified auditor's  
24 opinion included in the Company's 2005 Form 10-K and quoted above in ¶921.  
25  
26  
27



947. Deloitte's unqualified auditor's report was incorporated into the October 2007 Offering Documents. Specifically, the October 2007 Offering Documents incorporated by reference Deloitte's reports, stating that it was "so incorporated in reliance upon the report of [Deloitte] given upon their authority as experts in accounting and auditing."

948. Deloitte's unqualified auditor's report, as included in the 2006 Form 10-K, was materially untrue and misleading because, as explained above, the Company's consolidated financial statements did not fairly present the Company's financial condition and were not prepared in accordance with GAAP. Moreover, in certifying WaMu's 2006 financial statements, Deloitte falsely represented that its audits were conducted in accordance with GAAS.

**3. The October 2007 Offering Documents Contained Untrue Statements Regarding the Effectiveness of WaMu's Internal Controls**

949. The October 2007 Offering Documents also contained materially untrue and misleading statements regarding the effectiveness of WaMu's internal controls over financial reporting. Specifically, in the Company's 2006 Form 10-K, management reported on the effectiveness of WaMu's internal controls. In the same or substantially similar language as that stated in the 2005 Form 10-K, reported above at ¶924 above, the Company certified that it has created and maintained a system of effective internal controls over financial reporting.

950. The First Quarter 2007 Form 10-Q and the Second Quarter 2007 Form 10-Q, which were also incorporated by reference into the October 2007 Offering Documents, also included materially untrue certifications regarding the effectiveness of WaMu's internal controls in substantially the same language as that found in ¶925 above.

951. The 2006 Form 10-K included an unqualified auditor's report by Deloitte, opining on the effectiveness of WaMu's internal control over financial reporting. This report, dated

February 26, 2007, stated in language the same or substantially similar to that in ¶927 above, that WaMu had maintained effective internal controls over financial reporting as of December 31, 2006.

952. The Company's statements certifying WaMu's internal controls were false and misleading because the Company's extremely loose underwriting and its practice of artificially inflating appraisal values, demonstrate that the Company's internal controls were materially deficient. Contrary to these repeated internal control certifications, the Company was operating without adequate controls in place to ensure compliance with the Company's underwriting and appraisal standards. Further, WaMu was operating without policies and appropriate methodology in place to ensure the soundness of its valuation of its assets and its Allowance, which, as set forth above, was materially understated at the time of the October 2007 Offerings and during the Class Period. These failures demonstrate serious deficiencies in the Company's internal controls and contributed to materially distorting the Company's reporting of financial data.

953. Further, Deloitte's report on WaMu's internal controls was likewise materially false and misleading. For the reasons explained herein, the Company's internal controls were materially deficient.

#### **4. The October 2007 Offering Documents Contained Material Omissions Regarding the NYAG Complaint**

954. The October 2007 Offering was announced on October 25, 2007, six days before the Attorney General Cuomo filed the bombshell complaint alleging collusion between WaMu and its third-party appraisers. Upon the disclosure of the Attorney General's allegations, the price of WaMu common stock dropped from a close of \$27.88 per share on October 31, 2007 to a closing price of \$23.81 per share on November 2, 2007, a drop of \$4.07, or almost 15%. The

price of the 7.250% Notes (as well as WaMu's other securities discussed herein) also dropped from the disclosure of this news. The Company never disclosed that the imminent filing of the NYAG Complaint would expose its collusion with its third-party appraisers, an explosive fact of which, on information and belief, the Company was aware. The Attorney General's allegations and the effect WaMu's dubious appraisal practices were certain to have on the market for WaMu stock, were material facts that should have been disclosed to investors.

**E. The December 2007 Offering**

955. On or about December 17, 2007, WaMu conducted the December 2007 Offering, an offering consisting of the Series R Stock. The Company raised \$2.9 billion in capital from this secondary offering. The Company intended to contribute up to \$1 billion of the proceeds from the December 2007 Offering to Washington Mutual Bank, WaMu's principal bank subsidiary, as additional capital, and retain the remainder for general corporate purposes.

956. The December 2007 Offering Documents incorporated by reference several of WaMu's public filings, including the 2006 Form 10-K, which was audited by Deloitte and certified as in conformance with GAAP, and its Forms 10-Q for the quarters ended March 31, 2007 (the "First Quarter 2007 Form 10-Q"), June 30, 2007 (the "Second Quarter 2007 Form 10-Q"), and September 30, 2007 (the "Third Quarter 2007 Form 10-Q"). The December 2007 Offering also incorporated several of the Company's Current Reports filed on Form 8-K, including the Current Report for December 10, 2007. As noted above, the 2006 Form 10-K was signed by Defendants Killinger, Casey, Farrell, Woods, Frank, Montoya, Pugh, Leppert, Reed, Lillis, Smith, Matthews, Stever, Murphy, and Osmer-McQuade. The First Quarter 2007 Form 10-Q, the Second Quarter 2007 Form 10-Q, and the Third Quarter 2007 Form 10-Q were signed by Defendants Casey and Ballenger.

957. As noted above, Lehman Brothers and Morgan Stanley acted as representatives of the underwriters, and, together with Credit Suisse and Goldman Sachs, served as joint book-running managers for the December 2007 Offering.

958. The December 2007 Offering Documents contained numerous false and misleading statements related to the Company's underwriting practices and financial statements. As noted above, the December 2007 Offering Documents incorporated by reference the 2006 Form 10-K, as well as First Quarter 2007 Form 10-Q, the Second Quarter Form 10-Q, and the Third Quarter 2007 Form 10-Q. Each of these filings contained false and misleading statements. Additionally, the December 2007 Prospectus was rife with false and misleading statements regarding the Company's underwriting practices and the causes of the Company's losses. In each of these documents, the Company omitted numerous key facts that were necessary to make statements in the December 2007 Offering Documents not misleading.

**1. The December 2007 Offering Documents  
Misstated the Company's Lending  
Practices**

959. The statements in the Company's 2006 Form 10-K falsely described the Company's risk management and underwriting practices, as discussed in ¶¶933-936 above.

960. The Company also discussed its Option ARM loans and specifically referred investors to "Management's Discussion and Analysis of Financial Condition and Results of Operations – Credit Risk Management" in the 2006 Form 10-K. The referenced portion states, in pertinent part:

In 2006, the Finance Committee of the Board of Directors approved a set of credit risk concentration limits. These limits facilitate a more rigorous and quantitative framework that better enables the credit risk management function to proactively manage credit risk.

961. The Company's statements in the 2006 Form 10-K, which were incorporated into the December 2007 Offering Documents, regarding its risk management and underwriting were materially false and misleading because the Company was, in fact, lowering its underwriting standards and issuing loans that were increasingly unlikely to be repaid. The Company did not comply with its underwriting standards and did not actively manage its risk. The Company underwrote high-risk loans to borrowers who were not able to repay such loans and made exceptions to its underwriting guidelines as a matter of course. Indeed, the Company omitted from the December 2007 Documents the key facts that, during the third quarter of 2005, the Company loosened underwriting standards and increased its exceptions to those underwriting standards in order to increase loan volume. The Company also omitted to state that it had relegated its credit management function to a secondary "support" role and that its loan loss methodology did not appropriately analyze the actual deterioration of the Company's loan quality at least until summer 2007.

## **2. The December 2007 Offering Documents Contained Untrue Financial Results**

962. As discussed above in ¶¶937-945, in its 2006 Form 10-K WaMu and Defendant Deloitte made repeated false and misleading statements regarding the Company's financial condition, including misstating the Company's Allowance, thus inflating net income and total assets. The financial statements reported in the First Quarter 2007 Form 10-Q and the Second Quarter Form 10-Q were similarly misstated.

963. Additionally, the Third Quarter 2007 Form 10-Q, which was also incorporated into the December 2007 Offering Documents, reported assets of \$330.1 billion, net income of \$186 million, diluted earnings per common share of \$0.20, a provision for loan and lease losses of \$967, and an Allowance of \$1.5 billion.

1           964. The December 2007 Prospectus contained numerous false and misleading  
2 statements regarding the Company's financial condition and the causes for the losses the  
3 Company suffered in the fourth quarter of 2007. The Company attributed its "challenges" to  
4 "continuing disruptions in the mortgage and capital markets" and "continued deterioration in the  
5 mortgage markets and declining housing prices[.]" Further, under "Risk Factors," WaMu stated  
6 that the Company's liquidity may be affected by "circumstances beyond [the Company's]  
7 control." The circumstances that were supposedly beyond the Company's control included  
8 "significant volatility in the subprime secondary mortgage market." Further, the Company stated  
9 that:  
10

11           Economic conditions that negatively affect housing prices and the job market  
12 have resulted, and may continue to result, in a deterioration in credit quality of our  
13 loan portfolios, and such deterioration in credit quality has had, and could  
14 continue to have, a negative impact on our business.

15           965. These statements concerning the Company's financial results and compliance  
16 with GAAP were materially untrue and misleading. Specifically, the Company's reported  
17 financial results in the December 2007 Offering Documents misrepresented the value of the  
18 Company's net income, earnings per share, Allowance, provision for loan and lease losses and  
19 assets because the Company failed to properly account for the increased risks of default that  
20 accompanied the Company's departure from its lending standards, including its improper  
21 underwriting practices. The Company failed to disclose that, in loosening its underwriting  
22 guidelines, WaMu materially understated its Allowance and materially inflated the Company's  
23 reported earnings and net income. As discussed above at ¶¶941-942, these practices resulted in  
24 the Company's reported net income, assets, and diluted earnings per share being overstated for  
25 full-year 2006, first quarter 2007 and second quarter 2007. Additionally, the financial statements  
26 reported for the third quarter 2007 were similarly misstated.  
27

1 966. Further, the Company's statements in the December 2007 Prospectus, attributing  
2 WaMu's losses to a market-wide upheaval, were also materially false and misleading. At no  
3 point in the December 2007 Offering Documents did the Company discuss how its deteriorated  
4 underwriting standards materially undermined its financial condition, caused its losses, and  
5 caused its Allowance to be materially understated.  
6

7 **3. The December 2007 Offering Documents**  
8 **Contained Untrue Statements Regarding**  
9 **the Effectiveness of WaMu's Internal**  
10 **Controls**

11 967. The December 2007 Offering Documents contained the same materially untrue  
12 and misleading statements regarding the effectiveness of WaMu's internal controls over financial  
13 reporting as did the October 2007 Offering Documents, discussed above at ¶¶949-950.  
14 Specifically, in the Company's 2006 Form 10-K, First Quarter 2007 Form 10-Q and Second  
15 Quarter 2007 Form 10-Q, which were also incorporated by reference into the October 2007  
16 Offering Documents, all contained materially untrue certifications regarding the effectiveness of  
17 WaMu's internal controls in substantially the same language as that found in ¶¶924-925 above.  
18 Similarly, the Third Quarter 2006 Form 10-Q contained the same or substantially similar  
19 certification of internal controls.

20 968. As discussed above, the 2006 Form 10-K included an unqualified auditor's report  
21 by Deloitte, opining on the effectiveness of WaMu's internal control over financial reporting.

22 969. The Company's statements certifying WaMu's internal controls were false and  
23 misleading because the Company's extremely loose underwriting demonstrates that the  
24 Company's internal controls were materially deficient. Contrary to these repeated internal  
25 control certifications, the Company was operating without adequate controls in place to ensure  
26 compliance with the Company's underwriting standards. Further, WaMu was operating without  
27

1 policies and appropriate methodology in place to ensure the soundness of its valuation of its  
2 assets and its Allowance, which, as set forth above, was materially understated at the time of the  
3 December 2007 Offering and during the Class Period. These failures demonstrate serious  
4 deficiencies in the Company's internal controls and contributed to materially distorting the  
5 Company's reporting of financial data.

6  
7 970. Further, Deloitte's report on WaMu's internal controls was likewise materially  
8 false and misleading. For the reasons explained herein, the Company's internal controls were  
9 materially deficient.

#### 10 **FOURTH CLAIM FOR RELIEF**

11 **For Violations of Section 11 of the Securities Act In Connection With**  
12 **The Offerings Against Defendants WaMu; Killinger; Casey; Woods; Farrell;**  
13 **Frank; Leppert; Lillis; Matthews; Montoya; Murphy; Osmer-McQuade; Pugh; Reed;**  
14 **Smith; Stever; Wood; Deloitte; Goldman Sachs; Morgan Stanley; Credit Suisse; Deutsche**  
15 **Bank; Lehman Brothers; UBS; Banc of America; J.P. Morgan; Barclays; Keefe, Bruyette;**  
16 **Cabrera Capital; Williams Capital; Citigroup; Greenwich; BNY; and Ramirez & Co.**

17 971. Plaintiffs repeat and reallege each and every allegation above relating to the  
18 Securities Act claims as if fully set forth herein. Defendants' liability under this Claim for Relief  
19 is predicated on the participation of each Defendant in conducting the Offerings pursuant to the  
20 Registration Statement, which contained untrue statements and omissions of material fact. This  
21 Claim for Relief does not sound in fraud. Any allegations of fraud or fraudulent conduct and/or  
22 motive are specifically excluded. For purposes of asserting this and their other claims under the  
23 Securities Act, Plaintiffs do not allege that Defendants acted with intentional, reckless or  
24 otherwise fraudulent intent.

25 972. This claim is brought pursuant to Section 11 of the Securities Act against  
26 Defendants WaMu; Killinger; Casey; Woods; Farrell; Frank; Leppert; Lillis; Matthews;



1 Montoya; Murphy; Osmer-McQuade; Pugh; Reed; Smith; Stever; Wood; Deloitte; Goldman  
2 Sachs; Morgan Stanley; Credit Suisse; Deutsche Bank; Lehman Brothers; UBS; Banc of  
3 America; J.P. Morgan; Barclays; Keefe, Bruyette; Cabrera Capital; Williams Capital; Citigroup;  
4 Greenwich; BNY; and Ramirez & Co. (collectively, the “Section 11 Defendants”), on behalf of  
5 members of the Class who purchased or otherwise acquired the securities issued pursuant and/or  
6 traceable to the Offerings and were damaged by the acts alleged herein. This claim is based  
7 solely in strict liability and negligence.  
8

9 973. Defendant WaMu was the issuer, within the meaning of Section 11 of the  
10 Securities Act, pursuant to the Offering Documents, including the Registration Statement,  
11 (defined in ¶817, above) of the registered securities set forth below.  
12

13 974. As discussed above, in August 2006, WaMu issued and sold to investors \$500  
14 million of floating rate notes due August 24, 2009, and \$400 million of 5.50% Notes due August  
15 24, 2011. Defendants Goldman Sachs, Morgan Stanley, Credit Suisse, Deutsche Bank, and  
16 Lehman Brothers were statutory underwriters for these registered securities, as admitted in the  
17 August 2006 Offering Documents.  
18

19 975. As discussed above, in September 2006, WaMu issued and sold to investors \$500  
20 million of depositary shares, each representing a 1/40,000th interest in a share of Series K  
21 Perpetual Non-Cumulative Floating Rate Stock. Defendants UBS, Goldman Sachs, Morgan  
22 Stanley, Credit Suisse, J.P. Morgan, Banc of America, and Lehman Brothers were statutory  
23 underwriters for these registered depositary shares, as admitted in the September 2006 Offering  
24 Documents.  
25

26 976. As discussed above, in October 2007, WaMu issued and sold to investors \$500  
27 million of 7.250% subordinated notes due November 1, 2017. Defendants Barclays; Credit  
28

1 Suisse; Lehman Brothers; Morgan Stanley; Keefe, Bruyette; Cabrera Capital; and Williams  
2 Capital were statutory underwriters for these registered securities, as admitted in the October  
3 2007 Offering Documents.

4 977. As discussed above, in December 2007, WaMu issued and sold to investors \$3  
5 billion of the Series R Stock. Defendants Lehman Brothers; Morgan Stanley; Credit Suisse;  
6 Goldman Sachs; Barclays; Citigroup; Deutsche Bank; J.P. Morgan; Greenwich; UBS; BNY;  
7 Cabrera Capital; Keefe, Bruyette; Ramirez & Co.; and Williams Capital were statutory  
8 underwriters for the registered securities, as admitted in the December 2007 Offering  
9 Documents.  
10

11 978. Defendants Killinger, Casey, Woods, Farrell, Frank, Leppert, Lillis, Matthews,  
12 Murphy, Osmer-McQuade, Pugh, Reed, Smith, Stever, and Wood each signed the Registration  
13 Statement, which was then updated and incorporated into the Offering Documents, as a senior  
14 officer and/or director of WaMu within the meaning of Section 11 of the Securities Act.  
15 Defendant Montoya was a director at WaMu at the time of the filing of the Offering Documents.  
16

17 979. Deloitte consented to the incorporation of its unqualified auditor's report  
18 regarding WaMu's financial statements into the Offering Documents, including the Registration  
19 Statement. Specifically, Deloitte consented to the incorporation into the August 2006 Offering  
20 Documents and the September 2006 Offering Documents of its unqualified auditor's report on  
21 WaMu's financial statements included in the Company's 2005 Form 10-K. Deloitte consented to  
22 the incorporation into the October 2007 Offering Documents and the December 2007 Offering  
23 Documents of its unqualified auditor's report on WaMu's financial statements included in the  
24 Company's 2006 Form 10-K. As detailed herein, the misrepresentations contained in, or the  
25 material facts omitted from, the Offering Documents included, but were not limited to, the facts  
26  
27

1 that: (i) the financial statements that Deloitte certified as being presented in conformity with  
2 GAAP were not presented in conformity with GAAP, and (ii) Deloitte's audits, which it attested  
3 were conducted in accordance with GAAS, were not conducted in accordance with GAAS.

4 980. The registered securities described in this Count were issued and sold pursuant to  
5 the Offering Documents. All purchases of the registered securities after the issuance of the  
6 August 2006 Offering Documents are traceable to the August 2006 Offering Documents. All  
7 purchases of the registered securities after the issuance of the September 2006 Offering  
8 Documents are traceable to the September 2006 Offering Documents. All purchases of the  
9 registered securities after the issuance of the October 2007 Offering Documents are traceable to  
10 the October 2007 Offering Documents. All purchases of the registered securities after the  
11 issuance of the December 2007 Offering Documents are traceable to the December 2007  
12 Offering Documents.

13 981. The Offering Documents, including the Registration Statement, contained untrue  
14 statements of material fact and omitted to state material facts required to be stated therein or  
15 necessary to make the statements therein not misleading.

16 982. Defendants issued and disseminated, caused to be issued and disseminated, and  
17 participated in the issuance and dissemination of, material misstatements to the investing public  
18 which were contained in the Offering Documents, which misrepresented or failed to disclose the  
19 material adverse facts alleged in connection with Plaintiffs' Securities Act claims, as set forth  
20 above.

21 983. In connection with offering the registered securities to the public and the sale of  
22 those securities, the Section 11 Defendants, directly or indirectly, used the means and  
23

1 instrumentalities of interstate commerce, the United States mails and a national securities  
2 exchange.

3 984. As the issuer of the registered securities, WaMu is strictly liable for the untrue  
4 statements of material fact and material omissions described herein.

5 985. None of the other Section 11 Defendants made a reasonable investigation or  
6 possessed reasonable grounds for the belief that the statements contained in the Offering  
7 Documents were accurate and complete in all material respects. Had they exercised reasonable  
8 care, they would have known of the material misstatements and omissions alleged herein.

9 986. Class members did not know, nor in the exercise of reasonable diligence could  
10 have known, that the Offering Documents contained untrue statements of material fact and  
11 omitted to state material facts required to be stated or necessary to make the statements  
12 particularized above not misleading when they purchased or acquired the registered securities.

13 987. As a direct and proximate result of Defendants' acts and omissions in violation of  
14 the Securities Act, the Class suffered substantial damage in connection with its purchase of the  
15 Floating Rate Notes and the 5.50% Notes pursuant to the August 2006 Offering Documents, the  
16 Series K Stock pursuant to the September 2006 Offering Documents, the 7.250% Notes pursuant  
17 to the October 2007 Offering Documents and/or the Series R Stock pursuant to the December  
18 2007 Offering Documents. By reason of the conduct alleged herein, each Defendant violated  
19 Section 11 of the Securities Act.

20 988. By reason of the foregoing, the Section 11 Defendants are liable to the members  
21 of the Class who acquired registered securities pursuant to or traceable to the Offering  
22 Documents.

989. This claim is brought within one year after the discovery of the untrue statements and omissions, and within three years after the issuance of the Offering Documents.

#### **FIFTH CLAIM FOR RELIEF**

**For Violations of Section 12(a)(2) of the Securities Act In Connection With The Offerings Against Defendants WaMu; Goldman Sachs; Morgan Stanley; Credit Suisse; Deutsche Bank; Lehman Brothers; UBS; Banc of America; J.P. Morgan; Barclays; Keefe, Bruyette; Cabrera Capital; Williams Capital; Citigroup; Greenwich; BNY; and Ramirez & Co**

990. Plaintiffs repeat and reallege each and every allegation above relating to the Securities Act claims as if fully set forth herein. For the purposes of this Count, Plaintiffs assert only strict liability and negligence claims, and expressly exclude from this count any allegations of fraud or reckless or intentional misconduct, and expressly exclude from this Count any allegations of fraud or reckless or intentional misconduct.

991. This claim is brought pursuant to Section 12(a)(2) of the Securities Act, 15 U.S.C. §77k, against Defendant WaMu, as well as Defendants Goldman Sachs; Morgan Stanley; Credit Suisse; Deutsche Bank; Lehman Brothers; UBS; Banc of America; J.P. Morgan; Barclays; Keefe, Bruyette; Cabrera Capital; Williams Capital; Citigroup; Greenwich; BNY; and Ramirez & Co. (the "Underwriter Defendants"), on behalf of members of the Class who purchased or otherwise acquired WaMu securities pursuant and/or traceable to the Offering Documents, including the August 2006 Prospectus, the September 2006 Prospectus, the October 2007 Prospectus and December 2007 Prospectus, and were damaged by acts alleged herein.

992. By means of the Offering Documents, including the August 2006 Prospectus, the September 2006 Prospectus, the October 2007 Prospectus and December 2007 Prospectus, and by using the means and instruments of transportation and communication in interstate commerce

1 and of the mails, Defendant WaMu and the Underwriter Defendants, through public offerings,  
2 solicited and sold WaMu securities to members of the Class.

3 993. The Offering Documents, including the August 2006 Prospectus, the September  
4 2006 Prospectus, the October 2007 Prospectus and December 2007 Prospectus, were materially  
5 misstated, omitted to state facts necessary to make the statements made not misleading, and  
6 concealed or failed to adequately disclose material facts as alleged herein.  
7

8 994. None of the Underwriter Defendants made a reasonable investigation or possessed  
9 reasonable grounds for the belief that the statements contained in the Offering Documents,  
10 including the August 2006 Prospectus, the September 2006 Prospectus, the October 2007  
11 Prospectus and the December 2007 Prospectus, were accurate and complete in all material  
12 respects. Had they exercised reasonable care, these Defendants would have known of the  
13 material misstatements and omissions alleged herein.  
14

15 995. Members of the Class purchased WaMu securities by means of the materially  
16 misstated Offering Documents. At the time they purchased shares in the Offerings, no member  
17 of the Class knew, or by the reasonable exercise of care could have known, of the material  
18 misstatements in and omissions from the Offering Documents, including the August 2006  
19 Prospectus, the September 2006 Prospectus, the October 2007 Prospectus and December 2007  
20 Prospectus the Offering Documents were materially misstated, omitted to state facts necessary to  
21 make the statements made not misleading and concealed or failed to adequately disclose material  
22 facts as alleged herein.  
23

24 996. By virtue of the conduct alleged herein, WaMu and the Underwriter Defendants  
25 violated Section 12(a)(2) of the Securities Act.  
26  
27

1 997. Accordingly, members of the Class who purchased or otherwise acquired WaMu  
2 securities have a right to rescind and recover the consideration paid for their securities and  
3 hereby elect to rescind and tender their securities to WaMu and the Underwriter Defendants.  
4 And, members of the Class who have sold their WaMu securities issued in or traceable to the  
5 Offerings are entitled to rescissory damages.

6  
7 998. This claim is brought within one year after the discovery of the misstatements and  
8 omissions contained in the Offering Documents and within three years after the Offerings.

9  
10 **SIXTH CLAIM FOR RELIEF**

11 **For Violations of Section 15 of the Securities Act In Connection With**  
12 **The Offerings Against Defendants Killinger, Casey, Woods, Ballenger, Farrell, Frank,**  
13 **Leppert, Lillis, Matthews, Montoya, Murphy, Osmer-McQuade, Pugh, Reed, Smith,**  
14 **Stever, and Wood**

15 999. Plaintiffs repeat and reallege each and every allegation above relating to the  
16 Securities Act claims as if fully set forth herein, and expressly exclude from this Count any  
17 allegations of fraud or intentional misconduct.

18 1000. This claim is brought pursuant to Section 15 of the Securities Act, 15 U.S.C.  
19 §77o, against Defendants Killinger, Casey, Woods, Ballenger, Farrell, Frank, Leppert, Lillis,  
20 Matthews, Montoya, Murphy, Osmer-McQuade, Pugh, Reed, Smith, Stever, and Wood, on behalf  
21 of members of the Class who purchased or otherwise acquired WaMu securities pursuant and/or  
22 traceable to the Offering Documents and were damaged by acts alleged herein. For the purposes  
23 of this Count, Plaintiff asserts only strict liability and negligence claims and expressly disclaims  
24 any allegation of fraud or intentional misconduct.

25 1001. At all relevant times, Defendants Killinger, Casey, Woods, Ballenger, Farrell,  
26 Frank, Leppert, Lillis, Matthews, Montoya, Murphy, Osmer-McQuade, Pugh, Reed, Smith,

1 Stever, and Wood were controlling persons of the Company within the meaning of Section 15 of  
2 the Securities Act. As set forth herein, because of their positions in the Company and/or their  
3 stock ownership, and/or because of their positions on the WaMu Board, Defendants Killinger,  
4 Casey, Woods, Ballenger, Farrell, Frank, Leppert, Lillis, Matthews, Montoya, Murphy, Osmer-  
5 McQuade, Pugh, Reed, Smith, Stever, and Wood had the requisite power to directly or indirectly  
6 control or influence the specific corporate policy which resulted in the unlawful acts and conduct  
7 alleged herein.  
8

9 1002. Specifically, Defendants Killinger, Casey, Woods and Ballenger each served as an  
10 executive officer of WaMu. Defendant Killinger served as WaMu's Chief Executive Officer and  
11 Chairman of its Board; Defendant Casey served as its Chief Financial Officer; and Defendant  
12 Woods served as its Senior Vice President and Controller; and Defendant Ballenger served as  
13 Senior Vice President and Assistant Controller and Controller. As such, at all times relevant,  
14 Defendants Killinger, Casey, Woods and Ballenger each participated in the operation and  
15 management of the Company, conducted and participated, directly and indirectly, in WaMu's  
16 business affairs and mortgage-lending operations. These Defendants also participated in the  
17 preparation and dissemination of the Offering Documents, certain of the financial statements  
18 incorporated by reference therein and/or otherwise participated in the process necessary to  
19 conduct the Offerings. Because of their positions of control and authority as senior officers of  
20 WaMu, each of these Defendants were able to, and did, control the contents of certain or all the  
21 Offering Documents and the financial statements incorporated by reference therein, which  
22 contained materially false financial information.  
23  
24

25 1003. Similarly, at all times relevant, Defendants Farrell, Frank, Leppert, Lillis,  
26 Matthews, Montoya, Murphy, Osmer-McQuade, Pugh, Reed, Smith, Stever, and Wood served as  
27



1 Directors on WaMu's Board at the time the Offerings were conducted and/or at the time that the  
2 Registration Statement was signed. As directors of a publicly-owned company, these Defendants  
3 had a duty to disseminate accurate and truthful information with respect to WaMu's financial  
4 condition and results of operations. These Defendants each signed the Registration Statement;  
5 signed the 2005 Form 10-K which was incorporated by reference into the August 2006 Offering  
6 Documents and the September 2006 Offering Documents; signed the 2006 Form 10-K which  
7 was incorporated by reference into the October 2007 Offering Documents and the December  
8 2007 Offering Documents; and/or were Directors at the time the Offerings were conducted, the  
9 Offering Documents were disseminated to the investing public and the Registration Statement  
10 became effective. Thus, these Defendants controlled the contents and dissemination of the  
11 Offering Documents.  
12

13  
14 1004. By reason of the aforementioned conduct and by virtue of their positions as  
15 controlling persons of Defendant WaMu, each of the Defendants named in this Count is liable  
16 under Section 15 of the Securities Act, jointly and severally with, and to the same extent as the  
17 Company is liable under Sections 11 and 12(a)(2) of the Securities Act, to members of the Class  
18 who purchased or otherwise acquired WaMu securities pursuant to or traceable to the Offering  
19 Documents. As a direct and proximate result of the conduct of these Defendants, members of the  
20 Class suffered damages in connection with their purchase or acquisition of the securities.  
21

## 22 **XV. PRAYER FOR RELIEF**

23 WHEREFORE, Plaintiffs pray for relief and judgment, as follows:

- 24 A. Declaring this action to be a proper class action pursuant to Rule 23 of the Federal  
25 Rules of Civil Procedure on behalf of the Class defined herein;  
26  
27

- 1 B. Declaring and determining that the Defendants violated the federal securities laws as  
2 charged above;
- 3 C. Awarding Plaintiffs and the Class compensatory damages;
- 4 D. As to the claims set forth under the Securities Act (Sections 11, 12(a)(2) and/or 15),  
5 awarding rescission or a recessionary measure of damages;
- 6 E. Awarding Plaintiffs and the Class pre-judgment and post-judgment interest, as well as  
7 reasonable attorneys' fees, expert witness fees and other costs; and
- 8 F. Awarding such other relief for the benefit of the Class as this Court may deem just  
9 and proper.

11 **XVI. DEMAND FOR JURY TRIAL**

12 Plaintiffs hereby demand a trial by jury in this action of all issues so triable.  
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Dated: August 5, 2008

Respectfully Submitted,

BERNSTEIN LITOWITZ BERGER &  
GROSSMANN LLP

By: /s/ Chad Johnson  
Chad Johnson (*pro hac vice*)  
Hannah Ross (*pro hac vice*)  
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***Liaison Counsel for the Class***

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

IN RE WASHINGTON MUTUAL, INC.  
SECURITIES LITIGATION

This Document Relates to: ALL ACTIONS

No. 2:08-md-1919 MJP  
Lead Case No. C08-387 MJP

**CLASS ACTION COMPLAINT**

JURY DEMAND

**APPENDIX TO CONSOLIDATED CLASS ACTION COMPLAINT**

**List of Appendices:**

1. Confidential Witness List and Key
2. Summary of Claims Brought Pursuant to the Securities Exchange Act of 1934
3. Summary of Claims Brought Pursuant to the Securities Act of 1933
4. 2005 OTS Cover Letter and the Accompanying 2005 Interagency Appraisal Guidelines
5. Declaration of Sharon S. Fierstein
6. Declaration of Chad Coffman

## **APPENDIX 1**

**Confidential Witness List and Key**

<b>CW</b>	<b>Company</b>	<b>Tenure</b>	<b>Position(s)</b>
<b>1</b>	Washington Mutual	1991 – 2008	Due Diligence Director
<b>2</b>	Washington Mutual	1995 - 2008	Telephone Banker; Senior Loan Coordinator; Senior Credit Analyst; Assistant Vice President Credit Level 3, Underwriting Supervisor
<b>3</b>	Washington Mutual	1996 - 2008	Assistant Vice President & Branch Manager
<b>4</b>	Long Beach Mortgage	2003 – 2007	Account Executive
<b>5</b>	Washington Mutual	2003 – 2008	Senior Credit Risk Manager; Senior Credit Quality Manager
<b>6</b>	Washington Mutual	5/2007 – 12/2007	Senior Loan Consultant
<b>7</b>	Washington Mutual	2003 – 2007	Closing Loan Coordinator
<b>8</b>	Washington Mutual	2005 – 2007	Senior Loan Consultant
<b>9</b>	Washington Mutual	2/1998 – 9/2007	Senior Loan Coordinator
<b>10</b>	Washington Mutual	3/2007 – 12/2007	Loan Coordinator / Mortgage Processor
<b>11</b>	Washington Mutual	2007	Senior Loan Coordinator
<b>12</b>	Washington Mutual	2003 - 2007	Loan Consultant
<b>13</b>	Washington Mutual	1986 – 2006	Sales Manager
<b>14</b>	Washington Mutual / Long Beach Mortgage	1993 – 2006	Loan Closer; Loan Coordinator; Underwriter; Operations Manager; Loan Set-Up and Delivery Team Manager
<b>15</b>	Washington Mutual	2004 - 2007	First Vice President and Director of Investor Relations, New York
<b>16</b>	Washington Mutual	1999 – 2006	Senior Administrative Assistant; Executive Assistant; Senior Appraisal Coordinator
<b>17</b>	Washington Mutual	2001 – 2006	Senior Vice President, Enterprise Risk Management
<b>18</b>	Washington Mutual	2003 – 2006	Vice President, Commercial Risk
<b>19</b>	Washington Mutual	1983 – 2007	Senior Vice President, Compliance Manager
<b>20</b>	Washington Mutual	2002 – 2007	Division Finance Officer, Senior Manager
<b>21</b>	Washington Mutual	2005 – 2006	Vice President and Senior Market Risk Manager

**Confidential Witness List and Key**

<b>CW</b>	<b>Company</b>	<b>Tenure</b>	<b>Position(s)</b>
<b>22</b>	Washington Mutual	2007	Credit Risk Manager in the Capital Markets Group
<b>23</b>	Washington Mutual	1999-9/2006	Regional Manager in WaMu's Appraisal Department
	eAppraiseIT	9/2006 – 8/2007	Senior Appraisal Manager at eAppraiseIT
<b>24</b>	Washington Mutual	2001-2006	Senior Appraisal Coordinator
<b>25</b>	Washington Mutual	9/2003 – 11/2005	Loan Consultant
<b>26</b>	Washington Mutual	2005 – 2007	Loan Coordinator
<b>27</b>	Washington Mutual	1997 – 1999	Staff and Production Appraiser for WaMu
	eAppraiseIT and Lenders Services Inc.	1999 – 2006	WaMu-approved appraiser with eAppraiseIT and Lenders Services Inc. on an independent-contractor basis
<b>28</b>	Washington Mutual	11/2003 – 9/2006	Appraisal Field Manager
<b>29</b>	Washington Mutual	2002 – 2006	Senior Underwriter
<b>30</b>	Long Beach Mortgage	2004 – 9/2007	Account Executive
<b>31</b>	Washington Mutual	6/2003 – 2/2004	Staff Appraiser
<b>32</b>	eAppraiseIT	3/2004 – 3/2007	Customer Service Representative, Business Analyst
<b>33</b>	eAppraiseIT	2007	Liaison between eAppraiseIT appraisers and WaMu
<b>34</b>	eAppraiseIT	2006 – 2007	Real Estate Appraiser
<b>35</b>	eAppraiseIT	2006 – 2007	Customer Service Representative / Account Manager
<b>36</b>	eAppraiseIT	10/2006 – 8/2007	Appraisal Management Department
<b>37</b>	eAppraiseIT	6/2005 – 10/2007	Customer Service Representative
<b>38</b>	eAppraiseIT	2006	Customer Service Representative
<b>39</b>	Lenders Services Inc.	8/2006 – 2/2007	Appraisal Management Team
<b>40</b>	Lenders Services Inc.	2007 – 2008	Customer Service Representative and Reviewer
<b>41</b>	Lenders Services Inc.	2007	Appraisal Management Team and Client Services
<b>42</b>	Lenders Services Inc.	2007	Costumer Relations



**Confidential Witness List and Key**

<b>CW</b>	<b>Company</b>	<b>Tenure</b>	<b>Position(s)</b>
<b>43</b>	Lenders Services Inc.	2006	Appraisal Services Representative
<b>44</b>	Lenders Services Inc.	2006	Customer Service Specialist
<b>45</b>	Lenders Services Inc.	11/2006 – 12/2007	Client Services
<b>46</b>	Washington Mutual	2003 – 2006	Sales Assistant; Loan Consultant
<b>47</b>	Washington Mutual	1997 – 2008	Operations Manager; Credit Quality Manager; Area Underwriting Manager responsible for the East Coast; Negotiated Transaction Manager
<b>48</b>	Washington Mutual	2005 – 2008	Senior Underwriter Level V
<b>49</b>	Washington Mutual (through a private mortgage insurance company)	2007	Contractual Senior Underwriter
<b>50</b>	Washington Mutual	2001 – 2007	Mortgage Loan Consultant
<b>51</b>	Washington Mutual	2007 – 2008	Senior Underwriter
<b>52</b>	Washington Mutual	2004 – 2007	Underwriting Team Manager / Due Diligence Analyst
<b>53</b>	Washington Mutual	2004 – 2006; 3/2007-8/2007	Senior Loan Processor
<b>54</b>	Washington Mutual	2000 – 2007	Credit Risk Supervisor
<b>55</b>	Washington Mutual	2003 – 2008	Senior Underwriter Non-Prime
<b>56</b>	Washington Mutual	2007 – 2008	Underwriter
<b>57</b>	Washington Mutual	2002 – 2007	Trader
<b>58</b>	Washington Mutual	2005 -2007	Assistant Vice President, Credit Due Diligence for Capital Markets
<b>59</b>	Washington Mutual	2001 – 2008	Senior Risk Analyst in Risk Analytics Group
<b>60</b>	Washington Mutual	2002 – 2007	Retail Loan Consultant
<b>61</b>	Washington Mutual	2001 – 2007	Retail Loan Consultant
<b>62</b>	Washington Mutual	2005-2/2008	Senior Underwriter
<b>63</b>	Washington Mutual and Long Beach Mortgage	2001 – 2007	Vice President, National Underwriting Manager
<b>64</b>	Long Beach Mortgage	1998 – 2007	Account Executive
<b>65</b>	Washington Mutual and Long Beach Mortgage	2004 – 2007	Senior Underwriter
<b>66</b>	Washington Mutual	2004 – 2007	Senior Mortgage Underwriter
<b>67</b>	Long Beach Mortgage	2005 – 2007	Quality Assurance Manager
<b>68</b>	Long Beach Mortgage	2003 – 2006	Wholesale Mortgage Underwriter
<b>69</b>	Long Beach Mortgage	2003 – 2007	Senior Underwriter

**Confidential Witness List and Key**

<b>CW</b>	<b>Company</b>	<b>Tenure</b>	<b>Position(s)</b>
<b>70</b>	Long Beach Mortgage	2002 – 2007	Senior Underwriter
<b>71</b>	Washington Mutual	2003 – 2004	Senior Loan Coordinator
	Long Beach Mortgage	2005 - 2006	
<b>72</b>	Long Beach Mortgage	2004 – 2007	Account Executive
<b>73</b>	Long Beach Mortgage	2006	Underwriter
<b>74</b>	Long Beach Mortgage	2004 – 2006	Underwriter
<b>75</b>	Washington Mutual	2006	Underwriter
<b>76</b>	Washington Mutual	2007	Loan Processor, WaMu Specialty Lending; Senior Loan Coordinator, Long Beach Mortgage
	Long Beach Mortgage	2004 – 2007	
<b>77</b>	Long Beach Mortgage	1992 – 2007	Vice President, Operations Manager, Loan Center
<b>78</b>	Washington Mutual	2006 – 2008	Assistant Vice President / Analyst II, Risk Analytics Group
<b>79</b>	Washington Mutual	2002 – 2007	Senior Operations Excellence, Capital Markets; Senior Operations Excellence, Enterprise Risk Management
<b>80</b>	Washington Mutual	2006 – 2007	Senior Vice President, Accounting Policy
<b>81</b>	Washington Mutual	2006 - 2008	Staff Accountant, Home Loans Group
<b>82</b>	Washington Mutual	2001 – 2006	Quality Assurance Manager
<b>83</b>	Washington Mutual	2001 – 2006	Senior Foreclosure Loan Specialist
<b>84</b>	Washington Mutual	1989 – 2008	Senior Accountant
<b>85</b>	Washington Mutual	2006 – 2008	Staff Accountant in Home Loans Accounting
<b>86</b>	Washington Mutual	2005 – 2008	Underwriting Manager
<b>87</b>	Washington Mutual	1988 – 2007	Default Specialist III
<b>88</b>	Washington Mutual	2003 – 2007	Vice President and Manager, Policies & Procedure Administration Group
<b>89</b>	Long Beach Mortgage	2004 – 2007	First Vice President, Area Operations Manager

## **APPENDIX 2**

**SUMMARY OF CLAIMS BROUGHT PURSUANT TO THE  
SECURITIES EXCHANGE ACT OF 1934**

<b>DEFENDANTS</b>	<b>FIRST CLAIM FOR RELIEF §10(b)</b>	<b>SECOND CLAIM FOR RELIEF §20(a)</b>	<b>THIRD CLAIM FOR RELIEF §20(a)</b>
<b>THE COMPANY DEFENDANT</b>			
Washington Mutual, Inc.	X		
<b>THE OFFICER DEFENDANTS</b>			
Killinger, Kerry K.	X	X	
Casey, Thomas W.	X	X	
Cathcart, Ronald J.	X	X	
Rotella, Stephen J.	X	X	
Schneider, David C.	X	X	
<b>THE CONTROLLER DEFENDANTS</b>			
Woods, John F.		X	
Ballenger, Melissa J.		X	
<b>THE AUDIT COMMITTEE AND FINANCE COMMITTEE DEFENDANTS</b>			
Farrell, Anne V. (F)			X
Frank, Stephen E. (A, F)			X
Leppert, Thomas C. (A)			X
Lillis, Charles M. (A)			X
Matthews, Phillip D. (A)			X
Montoya, Regina (F)			X
Murphy, Michael K. (A, F)			X
Osmer-McQuade, Margaret (F)			X
Pugh, Mary E. (F)			X
Reed, William G., Jr. (A, F)			X
Smith, Orin C. (A, F)			X

(A) indicates membership on WaMu's Audit Committee during the Class Period

(F) indicates membership on WaMu's Finance Committee during the Class Period

## **APPENDIX 3**

**SUMMARY OF CLAIMS BROUGHT PURSUANT TO THE  
SECURITIES ACT OF 1933**

<b>DEFENDANTS</b>	<b>FOURTH CLAIM FOR RELIEF §11</b>	<b>FIFTH CLAIM FOR RELIEF §12(a)(2)</b>	<b>SIXTH CLAIM FOR RELIEF §15</b>
<b>THE WASHINGTON MUTUAL DEFENDANTS</b>			
Washington Mutual, Inc.	X	X	
Killinger, Kerry K.	X		X
Casey, Thomas W.	X		X
Woods, John F.	X		X
Farrell, Anne V.	X		X
Frank, Stephen E.	X		X
Leppert, Thomas C.	X		X
Lillis, Charles M.	X		X
Matthews, Phillip D.	X		X
Montoya, Regina	X		X
Murphy, Michael K.	X		X
Osmer-McQuade, Margaret	X		X
Pugh, Mary E.	X		X
Reed, William G., Jr.	X		X
Smith, Orin C.	X		X
Stever, James H.	X		X
Wood, Willis B., Jr.	X		X
Ballenger, Melissa J.			X
<b>THE AUDITOR DEFENDANT</b>			
Deloitte & Touche LLP	X		

**SUMMARY OF CLAIMS BROUGHT PURSUANT TO THE  
SECURITIES ACT OF 1933**

<b>DEFENDANTS</b>	<b>FOURTH CLAIM FOR RELIEF §11</b>	<b>FIFTH CLAIM FOR RELIEF §12(a)(2)</b>	<b>SIXTH CLAIM FOR RELIEF §15</b>
<b>THE UNDERWRITER DEFENDANTS</b>			
Goldman, Sachs & Co.	X	X	
Morgan Stanley & Co. Incorporated	X	X	
Credit Suisse Securities (USA) LLC	X	X	
Deutsche Bank Securities Inc.	X	X	
Lehman Brothers Inc.	X	X	
UBS Securities LLC	X	X	
Banc of America Securities LLC	X	X	
J.P. Morgan Securities Inc.	X	X	
Barclays Capital Inc.	X	X	
Keefe, Bruyette & Woods, Inc.	X	X	
Cabrera Capital Markets, LLC	X	X	
The Williams Capital Group, L.P.	X	X	
Citigroup Global Markets, Inc.	X	X	
Greenwich Markets, Inc.	X	X	
BNY Capital Markets, Inc.	X	X	
Samuel A. Ramirez & Company, Inc.	X	X	

## **APPENDIX 4**



**Office of Thrift Supervision**

Department of the Treasury

*Managing Director, Examinations, Supervision, and Consumer Protection*

1700 G Street, N.W., Washington, DC 20552 • (202) 906-7984

March 22, 2005

**MEMORANDUM FOR: CHIEF EXECUTIVE OFFICERS****FROM:**

Scott M. Albinson

**SUBJECT:**

Frequently Asked Questions (FAQ) on the Agencies' Appraisal Regulations and Related Guidance

The Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and National Credit Union Administration (the agencies) are issuing the attached FAQ document in response to questions from federally regulated institutions on the agencies' real estate appraisal standards. The FAQ topics address existing standards and include selecting individuals to perform appraisals and evaluations, ordering appraisals, accepting transferred appraisals, appraisal reviews, and evaluation development.

Savings associations' board of directors and management should review the FAQ in conjunction with the OTS appraisal regulations<sup>1</sup>, the Interagency Appraisal and Evaluation Guidelines<sup>2</sup> (October 1994), and the Interagency Statement on Independent Appraisal and Evaluation Functions (October 2003)<sup>3</sup>. Internal policies and procedures should ensure that, among other considerations, the savings association's appraisal and evaluation function is safeguarded from internal influence and interference from the loan production staff. Savings associations are also reminded that independence is compromised when an institution uses an appraiser who is recommended by the borrower or allows the borrower to select the appraiser.

For further information regarding the FAQ, contact Debbie Merkle, Project Manager, Credit Risk Policy at (202) 906-5688.

Attachment

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<sup>1</sup> 12 CFR Part 564.

<sup>2</sup> TB55a, Interagency Appraisal and Evaluation Guidelines, dated October 27, 1994 (<http://www.ots.treas.gov/docs/8/84042.pdf>).

<sup>3</sup> CEO Letter #184, Independent Appraisal and Evaluation Functions, dated October 27, 2003, (<http://www.ots.treas.gov/docs/2/25184.pdf>).

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**Office of the Comptroller of the Currency  
Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation  
Office of Thrift Supervision  
National Credit Union Administration**

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**Frequently Asked Questions on the Appraisal Regulations  
and the Interagency Statement<sup>1</sup> on  
Independent Appraisal and Evaluation Functions  
March 22, 2005**

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration (the agencies) prepared this document in response to questions from federally regulated institutions (regulated institutions) on existing standards for selecting appraisers, ordering appraisals, accepting transferred appraisals, and other related topics. It should be reviewed in conjunction with the agencies' appraisal regulations, the "Interagency Appraisal and Evaluation Guidelines" (interagency guidelines), dated October 27, 1994, and the joint statement "Independent Appraisal and Evaluation Functions" (independence statement), dated October 28, 2003.

**SELECTING AN APPRAISER AND ORDERING AN APPRAISAL**

1. *Do the interagency guidelines and independence statement apply for ordering and reviewing appraisals if the collateral property is residential (mortgage or home equity) rather than commercial?*

**Answer:** The agencies' guidance applies to both commercial and residential transactions. While the guidance does not differentiate between commercial and residential transactions, a regulated institution's appraisal policy and practices may differ for certain transactions. The regulated institution needs to consider the type of transaction when ordering appraisals, selecting appraisers, and reviewing appraisals. The transaction type should influence the type of appraisal that the regulated institution orders and whether the appraisal is eligible for a compliance review or should receive a comprehensive, analytical review prior to the credit decision. Moreover, for all lending activity, a regulated institution should ensure that independence is maintained when selecting appraisers, ordering appraisals, and reviewing appraisals.

2. *A regulated institution plans to make a construction loan to a tract developer to build 10 homes. Is it permissible for the developer to order appraisals on the properties and use them to support the construction loan request? Could the developer select an appraiser from*

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<sup>1</sup> See OCC: AL 2003-9; FRB: SR letter 03-18; FDIC: FIL-84-2003; OTS: CEO letter 184; and NCUA: LTCU 03-CU-17.

*the lender's approved appraiser list and in turn submit the appraiser's name to potential permanent lenders?*

**Answer:** No, the regulated institution may not accept a borrower-ordered appraisal and may not allow the borrower to select an appraiser from its approved appraiser list.

3. *Who should be considered the loan production staff for purposes of achieving appraiser independence? Could loan production staff select an appraiser?*

**Answer:** The loan production staff consists of those responsible for generating loan volume or approving loans, as well as their subordinates. This would include any employee whose compensation is based on loan volume. Employees responsible for the credit administration function or credit risk management are not considered loan production staff.

Loan production staff should not select appraisers. However, in a small or rural institution or branch, the only individual qualified to analyze the real estate collateral may also be a loan officer, other officer, or director of the institution. To ensure their independence, such lending officials, officers, and directors should abstain from any vote or approval involving loans for which they engaged the appraiser, reviewed the appraisal, or performed an evaluation.

4. *What information should the regulated institution provide to the appraiser upon engagement?*

**Answer:** The regulated institution should provide the property's address, its description, and any other relevant information. The regulated institution may also provide a copy of the sales contract for purchase transactions. However, the information provided by the regulated institution should not unduly influence the appraiser or in any way suggest the property's value. The regulated institution and the appraiser should agree on the scope of the appraisal in advance, consistent with the Uniform Standards of Professional Appraisal Practice (USPAP) and the agencies' appraisal regulations and interagency guidelines.

5. *When selecting residential appraisers, may loan production staff use a revolving pre-approved appraiser list, provided the list is not under their control?*

**Answer:** Yes, loan production staff may use a revolving, board-approved list to select a residential appraiser, provided the development and maintenance of the list is not under their control. Staff responsible for the development and maintenance of the list should be independent of the loan production process. In developing the list, a regulated institution should consider the knowledge and expertise of the selected appraiser for a given assignment. For example, the list should indicate the qualifications of the appraiser to perform appraisals in particular markets and on various types of residential property transactions. If the next available name on the list is not selected, the departure should be properly documented in the credit file. The administrative procedures should include a process for qualifying an appraiser for initial placement on the list as well as for periodic monitoring of the appraiser's performance to assess whether to retain an appraiser on the list. Further, there should be periodic internal review of the appraiser selection process to ensure that appropriate procedures are being followed and that controls exist to ensure independence.

6. *Must the individual appraiser, rather than the appraisal firm, sign and accept the terms of an engagement letter for it to be considered valid?*

**Answer:** The agencies have no specific requirements with respect to who signs and accepts the engagement letter. The appraiser, however, must sign the certification page of the appraisal report.

7. *Are appraisers required to disclose whether they have been engaged to appraise a given property in the past or is this information confidential?*

**Answer:** The agencies' appraisal regulations do not require that the regulated institution obtain information from appraisers as to whether they have previously appraised a given property. However, the regulations do require when engaging a fee appraiser that the regulated institution ensures that the appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction. The regulated institution should ask relevant questions of an appraiser to ensure that the appraiser is independent of the transaction and capable of rendering an unbiased opinion.

8. *When ordering appraisals, can a staff appraiser or an appraisal company affiliated with the regulated institution be considered independent since the regulated institution compensates them?*

**Answer:** Yes, if a staff appraiser prepares an appraisal, that appraiser must be independent of the lending, investment, and collections functions and not involved in the approval of the transaction. When fee appraisers from an affiliated appraisal company prepare appraisals, similar independence standards apply.

### **ACCEPTING A TRANSFERRED APPRAISAL**

9. *Can a regulated institution accept an appraisal from a prospective borrower and determine its acceptability based on a review?*

**Answer:** No, a regulated institution cannot accept a borrower-ordered appraisal.

10. *Can an appraisal be transferred from one lender to another and, if so, under what circumstances?*

**Answer:** A regulated institution may accept an appraisal transferred from another regulated institution or from a financial services institution (that is, a non-regulated institution), provided 1) the appraiser is engaged directly by the institution transferring the appraisal, 2) the appraiser has no direct or indirect interest in the property or transaction, 3) the existing appraisal or evaluation remains valid, and 4) the regulated institution determines that the appraisal conforms to the agencies' appraisal requirements and interagency guidelines and is otherwise appropriate. (A financial services institution describes entities that provide services in connection with real estate lending transactions on an ongoing basis.)

Regulated institutions are expected to perform a more thorough review when accepting an appraisal from another financial services institution to confirm that the appraisal complies with the regulation and has sufficient information to support the lending decision. Moreover, the regulated institution accepting the appraisal should determine whether appropriate documentation is available to confirm that the financial services institution (not the borrower) ordered the appraisal.

- 11. Can a regulated institution accept an appraisal prepared by an appraiser who was engaged by a loan broker?*

**Answer:** The agencies' appraisal regulations allow a regulated institution to accept an appraisal prepared by an appraiser engaged by another financial services institution, including a loan broker. This is allowed as long as the regulated institution has appropriate controls in place to ensure that the appraiser is acting on behalf of the financial services institution, the appraisal conforms to the requirements of the regulation and is otherwise acceptable, and the appraiser is independent from the borrower. Regulated institutions should review broker-ordered appraisals thoroughly to ensure that the appraisal complies with the regulation and meets the quality standards required by the institution's appraisal policies.

- 12. May an appraisal be readdressed to a regulated institution from the borrower or another institution?*

**Answer:** A regulated institution cannot accept an appraisal that has been readdressed or altered by the appraiser with the intent to conceal that the original client was the borrower. Readdressing appraisals to conceal the original client, whether the client is a borrower or another financial services institution, is misleading and violates the agencies' regulations and USPAP.

- 13. May an appraisal be routed from one lender to a regulated institution via the borrower?*

**Answer:** A regulated institution cannot accept an appraisal from the borrower unless the regulated institution can confirm that the appraisal was in fact ordered by another regulated institution or financial services institution. In accepting the appraisal, the regulated institution must also confirm that the appraiser is independent of the transaction and that the appraisal conforms to the agencies' appraisal regulations and is otherwise acceptable.

- 14. Can a borrower pay the appraiser directly for an appraisal that is ordered by the lender?*

**Answer:** Since the regulated institution has engaged the appraiser for its services, the regulated institution should be the party to remit payment to the appraiser. The regulated institution may seek reimbursement from the borrower for the cost of the appraisal. However, the borrower may not recommend an appraiser to the institution or select the appraiser.

15. *Can an appraiser deliver an appraisal report to more than one lender assuming the appraisal has been ordered by one of the lenders?*

**Answer:** The agencies' appraisal regulations do not address whether an appraiser can deliver an appraisal report to more than one lender. The case may depend upon the provisions of the engagement letter. For example, the lender may specify in the engagement letter that the appraisal may be provided to another financial institution if the lender decides not to go forward on the loan. In the case of a syndicated loan, a lead lender is usually responsible for engaging the appraiser and providing copies of the appraisal to the other participating financial institutions. With regard to standards of confidentiality, USPAP directs an appraiser to be aware of, and comply with, all confidentiality and privacy laws and regulations applicable in an assignment.

16. *Can the regulated institution accept an appraisal prepared by an appraiser who is a family member of the loan broker who engaged him/her?*

**Answer:** The agencies' appraisal regulations do not address family relationships between the appraiser and the person who engages the appraiser. However, the agencies' appraisal regulations do not permit a regulated institution to accept an appraisal in which the appraiser has a direct or indirect interest, financial or otherwise, in the property or the transaction. Therefore, the regulated institution should review appraisals where a potential conflict of independence may exist and should accept the appraisal only if it can determine that the appraiser is independent of the transaction.

17. *Can the regulated institution accept an appraisal prepared by an appraiser who is engaged by a financial services institution with whom the appraiser has an affiliated business relationship?*

**Answer:** The business relationship between the financial services institution and the appraiser may not necessarily violate the independence requirement of the agencies' appraisal regulations. However, the agencies' appraisal regulations do not permit a regulated institution to accept an appraisal in which the appraiser has a direct or indirect interest, financial or otherwise, in the property or the transaction. The regulated institution should evaluate the financial services institution's controls to ensure independence and that there is appropriate separation of responsibilities and reporting lines between the appraiser and the financial services institution's lending function.

18. *How can a regulated institution ensure appraiser independence when accepting an appraisal prepared for a financial services institution?*

**Answer:** Documentation (that is, an engagement letter) should be available to indicate that the financial services institution (not the borrower) ordered the appraisal and that the appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction. The original lender's engagement letter to the appraiser should be made part of the appraisal report to provide additional information on the identity of the client in order to ensure independence in the appraisal process.

## REVIEWING APPRAISALS

*19. Should all appraisals undergo a compliance review?*

**Answer:** Yes, prior to a final credit decision, regulated institutions should perform a compliance review on all appraisals to confirm that they comply with the minimum appraisal standards as outlined in the agencies' appraisal regulations, the interagency guidelines, and the independence statement. Loan administration files should document this compliance review, which may be in checklist or narrative format. In addition, certain appraisals should be reviewed more comprehensively to assess the technical quality of the appraiser's analysis prior to making a final credit decision. The regulated institution should establish guidelines for a more detailed, technical review based on transaction risk, transaction size, or other criteria. (See "Program Compliance" in the interagency guidelines.)

*20. Can a regulated institution approve a loan subject to receipt and review of an appraisal, or must the appraisal be obtained and reviewed prior to making the final decision?*

**Answer:** A regulated institution may grant conditional approvals to prospective borrowers before obtaining an appraisal. However, a final credit decision or action should only occur after the regulated institution receives, reviews, and accepts the appraisal.

*21. What qualifications would constitute a "qualified and adequately trained individual" for the purpose of conducting appraisal reviews?*

**Answer:** Individuals who review appraisals as part of a regulated institution's internal compliance function should be independent of the transaction and possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction.

## EVALUATION AND OTHER APPRAISAL TOPICS

*22. Can an otherwise qualified individual prepare an evaluation of a property securing a loan that will be approved by his/her direct supervisor? Can one officer perform an evaluation for another if they are both members of a loan committee, provided the evaluating officer abstains from voting? Could the lending officer or branch manager in a small, regulated institution perform the evaluation if he/she abstains from the final loan approval?*

**Answer:** To maintain independence, the individual preparing an evaluation should not directly report to someone involved in loan production. In a small, regulated institution where absolute lines of independence cannot be achieved, one officer may perform an evaluation for another as long as the evaluating officer abstains from the lending decision.



23. *Do the interagency guidelines apply only to loans in excess of \$250,000? Is the \$250,000 threshold the loan amount or the property value?*

**Answer:** The interagency guidelines apply to all real-estate-related financial transactions regardless of size or whether loans are for a regulated institution's own portfolio, held for sale, or held in asset-backed conduits. However, the agencies' appraisal regulations allow regulated institutions to use an appropriate evaluation of the real estate in lieu of an appraisal for transactions with a value of \$250,000 or less, business loans \$1 million or less, or subsequent transactions (transactions involving an existing extension of credit at the lending institution). The regulations define transaction value as the amount of the loan or extension of credit, not the value of the property. The interagency guidelines contain minimum standards for evaluation content and address the qualifications of individuals performing evaluations.

[Note: NCUA's business loan evaluation threshold is \$250,000 or less. (12 CFR Part 722.3(b)(2)]

24. *Should a regulated institution comply with the independence requirements if an appraisal is not required by the agencies' appraisal regulations?*

**Answer:** A regulated institution should ensure independence in the ordering process for an appraisal even if the appraisal was not required under the agencies' appraisal regulations. Regulated institutions should also maintain independence for evaluations.

25. *Does a tax-assessment value from the local taxing authority constitute an evaluation? Can a loan officer who approves and/or recommends a loan conduct an evaluation if the market value that the officer develops in the evaluation does not exceed the tax-assessment value?*

**Answer:** A value from the taxing authority alone is insufficient to be considered an evaluation. An evaluation report should include calculations, supporting assumptions, and, if utilized, a discussion of comparable sales. If tax assessment information is used as part of an evaluation, the regulated institution should document the facts and analysis used to demonstrate that there is a valid correlation between the assessed values of the taxing authority and the property's market value. In addition, an evaluation should describe the real estate collateral, its condition, and its current and projected use.

A regulated institution should ensure that an individual who performs an evaluation is independent of the loan production function. Simply restricting the size of a transaction to less than the tax-assessed value alone does not comply with the agencies' appraisal regulations or the interagency guidelines, which address standards of independence. (See "Independence of the Appraisal and Evaluation Function" in the interagency guidelines.)



26. *The work-out plan on a \$5 million problem loan calls for a regulated institution to receive an assignment of a \$2 million note from the borrower's relative secured by a deed of trust on a different property. Is this financial transaction considered real-estate-related and is an appraisal required on the collateral property?*

**Answer:** Yes, this is considered a real-estate-related financial transaction. The agencies' appraisal regulations and interagency guidelines allow for an evaluation in lieu of an appraisal on new real estate collateral in certain loan workout situations depending on loan quality, collateral quality, and validity of an existing appraisal or evaluation. (See "Renewals, Refinancings and Other Subsequent Transactions" in the interagency guidelines.)

27. *What is the useful life of an appraisal?*

**Answer:** The useful life of an appraisal varies with market conditions and property type. The agencies allow a regulated institution to use an existing appraisal to support a subsequent transaction if the institution documents that the existing value estimate remains valid. Factors which could impact the value include the passage of time; the volatility of the local market; the availability of financing; the inventory of competing properties; improvements to, or lack of maintenance of, the subject property or competing surrounding properties; changes in zoning; or environmental contamination. (See "Valid Appraisals and Evaluations" in the interagency guidelines.)

28. *Can a regulated institution advance new funds without a new appraisal if the value of the total loan continues to be supported by an existing appraisal and is consistent with supervisory LTV limits? Does the age of the appraisal matter if the physical condition of the property and the market conditions have not changed?*

**Answer:** A regulated institution may use an existing appraisal or evaluation to support a subsequent transaction, as long as the credit file documents the facts and analysis that support the institution's conclusion that the appraisal or evaluation remains valid. Criteria for determining whether an existing appraisal or evaluation remains valid will vary depending upon the condition of the property and the marketplace and the nature of any subsequent transaction.

## **APPENDIX 5**

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

IN RE WASHINGTON MUTUAL, INC.  
SECURITIES LITIGATION

This Document Relates to: ALL ACTIONS

No. 2:08-md-1919 MJP  
Lead Case No. C08-387 MJP

**DECLARATION OF SHARON SABBA FIERSTEIN, CPA**

I, Sharon Sabba Fierstein, being duly sworn, depose and say:

1. I am a Partner in the accounting firm of Marks Paneth & Shron LLP (“Marks Paneth”). I serve in the Litigation and Corporate Financial Advisory Services Group at the New York offices of Marks Paneth, located at 622 Third Avenue, New York, New York 10017. This Declaration is based on my personal knowledge concerning the matters stated herein, and I would testify to them, under oath, if called upon to testify before this Court.

2. As set forth in my curriculum vitae, a copy of which is attached as Exhibit A to this Declaration, I am a certified public accountant (“CPA”) licensed in the State of New York since 1984.

3. I am currently the President of the New York State Society of CPAs and serve as a council member as a New York State delegate to the American Institute of CPAs. For nearly ten years, I served as the Executive Vice President, Treasurer and Chief Financial Officer of a mortgage banking company. Prior to that, I was an Audit Manager for Deloitte, Haskins & Sells (a

predecessor of Deloitte & Touche LLP), which included a two-year special assignment where I served as Secretary to the International Auditing Practices Committee for the International Federation of Accountants. In that position, I contributed to the design and drafting of International Auditing Guidelines and other technical papers.

4. I was retained on an hourly, non-contingent basis by Lead Counsel, the firm of Bernstein Litowitz Berger & Grossmann LLP, to act as an accounting expert and consultant with respect to the accounting and auditing issues in this case.

5. From April 2008 through August 5, 2008, I, and others at my firm under my supervision, worked closely with Lead Counsel to analyze Washington Mutual Inc.'s ("WaMu's" or the "Company's") financial statements from 2004 through the present. I reviewed, among other things, the Company's publicly-issued financial statements filed with the Securities and Exchange Commission ("SEC") for the years ended December 31, 2004, December 31, 2005, December 31, 2006, and December 31, 2007; all reported interim financial statements for the years 2004 through 2007, and the first quarter of 2008; detailed financial information for the quarter ended June 30, 2008 filed as an exhibit to a Form 8-K filed by WaMu with the SEC on July 22, 2008; the Company's press releases; certain Wall Street analysts' reports on WaMu; certain internal WaMu documents provided to me on a confidential basis by Lead Counsel; as well as the relevant authoritative accounting and auditing literature relating to, *inter alia*, the accounting for impairment of loans, loan loss reserves, and internal controls. I have not reviewed the Company's internal accounting documents or any other documents of the type that may later be made available through discovery and which would enable me to further evaluate WaMu's accounting practices, including WaMu's Allowance for Loan and Lease Losses ("Allowance"). In addition to the work on this matter noted

above, I reviewed the Consolidated Class Action Complaint (the “Complaint”).

6. In forming my opinion (discussed below), I considered relevant accounting rules and standards that public companies such as WaMu would have been required to consider in the preparation of their financial statements. The Financial Accounting Standards Board (“FASB”), which has delegated authority from the SEC to promulgate GAAP for public companies, issued in 1978 Statement of Financial Accounting Standards No. 5, “Accounting for Contingencies” (“SFAS 5”). SFAS 5 indicates that companies must accrue losses as a charge to income when both (1) the information available indicates that it is probable that an asset is impaired and that it is probable that a future event will confirm the fact of loss, and (2) that the amount of loss can be reasonably estimated. Further, the SEC provided guidance to WaMu and other registrants for accounting for losses when it issued in 2001 SEC Staff Accounting Bulletin No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues” (“SAB 102”). SAB 102 provides several factors that should be considered when accounting for loan losses, including “levels of and trends in delinquencies and impaired loans . . . trends in volume and terms of loans . . . [and] effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices.” SAB 102 also advises that because “the allowance and provision for loan losses are significant elements of the financial statements. . . . it is appropriate for an entity’s management to review, on a periodic basis, its methodology for determining its allowance for loan losses.” In addition, the American Institute of Certified Public Accountants’ (AICPA) *Audit and Accounting Guide for Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies*, which was originally issued in 2004 and updated in 2007, instructs that if a faulty credit granting decision has been made, or loan credit

review procedures are inadequate or overly aggressive, a loss should be recognized at the date of loan origination.

7. I based my opinion of WaMu's accounting practices during the Class Period, which is explained in greater detail below, on the information set forth above, and on my expertise in the field of accounting.

8. Based upon my review of the information referred to above, it is my opinion that WaMu's methodology for accounting for its Allowance did not conform with Generally Accepted Accounting Principles ("GAAP") and SEC guidelines during the Class Period (October 17, 2005 through July 23, 2008) and that, based on my review of the allegations of the Complaint and certain of the internal WaMu documents referenced therein, WaMu lacked adequate internal controls over financial reporting with respect to WaMu's Allowance in, at least, the third and fourth quarters of 2005 and the first and second quarters of 2006. Furthermore, it is my opinion that the Company's violations of GAAP and SEC guidelines caused the Company, in its reported financial statements, to understate its Allowance, which in turn caused the Company to report overstated net income, overstated assets, and overstated diluted earnings per share throughout the Class Period.

9. Based upon my review of the information described above, including information relating to the manner in which WaMu originated and underwrote its loans, it is my opinion that the Company did not appropriately evaluate its loans for impairment at origination or in subsequent reporting periods in compliance with GAAP and SEC guidelines. It is my understanding that the information set forth in the Complaint was uncovered through Lead Counsel's investigation regarding WaMu's lending practices; such information indicates that the Company's lending practices became increasingly permissive in the third quarter of 2005 and continued through at least

November 1, 2007. In particular, information in the Complaint alleging that the Company engaged in unlawful appraisal practices and maintained deficient underwriting and risk management policies and practices, as well as the Complaint's allegations related to the deficiencies in the Company's model for calculating loan losses (the "Loan Performance Risk Model") indicate, assuming the truth of those allegations, that WaMu's Allowance was understated throughout the Class Period.

10. Based upon my review of the Complaint and certain internal WaMu documents referenced therein, it is also my opinion that the Company's internal controls over financial reporting with respect to WaMu's Allowance were deficient. In particular, and as discussed in the Complaint, an internal WaMu report that I reviewed indicates that management responsible for determining the Company's Allowance did not have an adequate methodology and sufficient data in order to calculate the Allowance in accordance with GAAP and SEC guidelines. Moreover, according to the internal WaMu documents I reviewed, certain of WaMu's deficient internal controls over financial reporting that related to its Allowance were not scheduled to be addressed for nine months – from the time they were identified in writing in September 2005 until June 30, 2006. However, my review of the Company's financial statements indicates that during that period, specifically for the third and fourth quarters of 2005 and the first and second quarters of 2006, the Company did not disclose those deficiencies and that the Company's internal controls over financial reporting were deficient.

I declare under penalty of perjury that the foregoing is true and correct.  
Executed in New York, New York on August 5, 2008.

  
Sharon Sabba Fierstein, CPA

## **EXHIBIT A**



**SHARON SABBA FIERSTEIN, CPA  
CURRICULUM VITAE**

**PROFESSIONAL EXPERIENCE**

2004 to Date	<b>Marks Paneth &amp; Shron LLP</b>  Partner, Litigation & Corporate Financial Advisory Services
2002 to 2004	<b>Eastern Funding, LLC</b>  Chief Financial Officer
1993 to 2002	<b>PW Funding Inc.</b>  Executive Vice President, Treasurer and Chief Financial Officer
1990 to 1993	<b>Metropolitan Life Insurance Company</b>
1990 to 1992	Divisional Controller
1992 to 1993	Profit Manager
1981 to 1990	<b>Deloitte Haskins &amp; Sells</b>  Audit Manager (New York Office)
1986 to 1988	<b>International Federation of Accountants</b>  Secretary to the International Auditing Practices Committee (secondment from Deloitte Haskins & Sells)

**PROFESSIONAL ACTIVITIES**

American Institute of Certified Public Accountants:

2004 to Date	Member of Council (New York Delegate)
1996 to 1996	Member of BIEC Professional Issues Subcommittee
1993 to 1994	Member of Work/Life and Women's Initiatives Executive Committee

American Woman's Society of Certified Public Accountants:

1991 to 1992	Vice President and Member of Executive Committee of National Board of Directors
1989 to 1992	Member of National Board of Directors

## **SHARON SABBA FIERSTEIN, CPA**

### **Professional Activities – (Continued)**

1988 to 1989	President of NYC Chapter
1986 to 1989	Member of Board of Directors of NYC Chapter

New York State Society of Certified Public Accountants:

2008 to Date	President, Chairman of the Board of Directors and Executive Committee
2007 to 2008	President-Elect, Member of the Board of Directors and Executive Committee, Chairman of Quality Enhancement Policy Committee
2005 to 2008	Member of Financial Accounting Standards Committee
2005 to 2008	Member of Human Resources Committee
2006 to 2007	Vice President, Member of the Board of Directors and Executive Committee
1999 to 2005	Trustee of the Foundation for Accounting Education
2002 to 2003	Chairman of Task Force on Bylaws Revision
2000 to 2002	Secretary, Member of Board of Directors and Executive Committee
2000 to 2002	Chairman of Committee on Committee Operations
1998 to 2000	Chairman of Finance Committee
1998 to 2002	Member of Committee on Committee Operations
1998 to 1999	Member of Annual Leadership Conference Committee
1997 to 1998	Vice President and Member of Board of Directors
1996 to 1998	Chairman of Interactive Online Resource Committee
1994 to 1997	Member of Board of Directors and Executive Committee
1993 to 1997	Member of Chief Financial Officers Committee
1991 to 1993	Member of General Committee on Members in Public Practice,
1991 to 1993	Chairman of Advancement of Women in the Accounting Profession Committee
1988 to 1991	Member of Promoting CPA Careers Committee

### **COMMUNITY ACTIVITIES**

National Association of Mothers' Centers

2002 to Date	Treasurer & Member of the Executive Committee
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Wesleyan University

1981 to Date	Member of Alumni Schools Committee
2000 to 2001	Chairman of Class of '81 20 <sup>th</sup> Reunion Committee

## **SHARON SABBA FIERSTEIN, CPA**

Woodbury Jewish Center

2001 to 2007                      Member of the Education Committee

### **EDUCATION**

New York University Stern School of Business - M.B.A., 1985

Wesleyan University - B.A. in Mathematics/Economics, 1981

Charles E. Merrill Scholar, 1977 - 1978

### **PROFESSIONAL CERTIFICATION**

Certified Public Accountant, New York, 1984

### **PROFESSIONAL MEMBERSHIPS**

Accountants Club of America  
American Institute of Certified Public Accountants  
American Woman's Society of Certified Public Accountants  
New York State Society of Certified Public Accountants

### **AWARDS**

2002 Recipient of Woman of Distinction in Business Award – Town of Oyster Bay  
1999 Recipient of Outstanding CPA in Industry Award – New York State Society of Certified Public Accountants

## **APPENDIX 6**

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

IN RE WASHINGTON MUTUAL, INC.  
SECURITIES LITIGATION

This Document Relates to: ALL ACTIONS

No. 2:08-md-1919 MJP  
Lead Case No. C08-387 MJP

DECLARATION OF CHAD COFFMAN, CFA

My name is Chad Coffman. I am the President of Winnemac Consulting, a Chicago-based firm that specializes in the application of economics, finance, statistics, and valuation principles to questions that arise in a variety of contexts, including, as here, in the context of litigation. My qualifications are set forth in the next section.

I have been asked by counsel for Plaintiffs to review their Consolidated Class Action Complaint ("Complaint") in regards to the Washington Mutual, Inc. ("WaMu") Securities Litigation and assess whether, in my opinion, assuming the truth of Plaintiffs' allegations, the Complaint has articulated an economically and logically sound basis for loss causation. To be clear, I have not been asked to quantify or determine the extent of loss causation at this stage of the litigation. A quantification of loss causation will require substantial factual and expert analysis with the benefit of discovery. My analysis is limited to evaluating whether the Complaint provides a sufficient link between allegations of fraud and information associated with declines in price and thus establishes a coherent theory of loss causation that can be

proven or rebutted by the parties at trial. In my opinion it has. In addition to my review of the Complaint, for the purpose of this report I have reviewed selected analyst reports and stock price information. The next section presents my qualifications and the remainder of the report provides the basis for my opinion.

### QUALIFICATIONS

I hold a Bachelors Degree in Economics with Honors from Knox College and a Masters in Public Policy from the University of Chicago. I am also a CFA charter-holder. The CFA, or Chartered Financial Analyst, designation is awarded to those who have sufficient practical experience and complete a rigorous series of three exams over three years that cover a wide variety of financial topics with a particular focus on valuation.

I, along with several others, founded Winnemac Consulting in March of this year. Prior to starting Winnemac Consulting, I was employed by Chicago Partners for over twelve years where I was responsible for conducting and managing analysis in a wide variety of areas including securities valuation and damages, labor discrimination and antitrust. I have been responsible for conducting loss causation, damages, and valuation analysis in some of the most high profile securities cases on record including Parmalat, Enron, Tyco, and WorldCom among others. I have been engaged numerous times as a valuation expert both within and outside the litigation context. My experience in class action securities cases includes work for plaintiffs, defendants, D&O insurers and more recently I have been engaged by a prominent mediator (Retired Judge Daniel Weinstein) to provide neutral economic analysis and opinions in several securities class actions as well as other matters.

My qualifications are further detailed in my curriculum vitae, which is attached as Exhibit A. Winnemac Consulting is being compensated at an hourly rate for my work on this matter and my compensation is not contingent on the outcome of the case.

### BASIS FOR OPINION

I understand loss causation to be a combination of the "but-for" test and the "foreseeability" test. In other words, would Plaintiffs have suffered the loss but-for Defendants' actions and was the loss a foreseeable consequence of their actions? The roles for economists in this

type of inquiry include evaluating the economic impact of the alleged fraud (in terms of how it would affect stock prices) and determining whether there is economic evidence to link later price declines (if any) to the revelation of the prior misstatements or omissions.

The Complaint details a series of fraud allegations, but in my mind there are two primary themes that capture many of them: (1) WaMu fraudulently influenced the appraisal process to obtain inflated asset appraisals, and (2) WaMu misrepresented the quality of its underwriting and loss reserving process. Plaintiffs assert that these fraudulent actions and misrepresentations caused the company's loan loss reserves to be knowingly and materially understated because the company faced materially greater risk of losses than disclosed. For example, if WaMu was relying on fraudulently inflated appraisal values, this would have the effect of overstating the value of collateral and understating loan to value ratios. These are important metrics used by practitioners in evaluating the quality of loan portfolios. In addition, if WaMu fraudulently overstated the quality of its underwriting and loss reserving standards, the market would underestimate expected credit losses. In both cases, the foreseeable consequence of the alleged fraud is that the Company, at some point, would have substantially higher than expected credit losses.

If we take Plaintiffs' allegations as well pled and true, then as a matter of economics it is clear that the market overvalued WaMu. The quantification of the extent to which WaMu was overvalued as a result of these alleged misstatements is a complex question that would be subject of expert analysis later in the litigation. However, it is clear that credit losses and loan loss reserves are important metrics in evaluating the performance of a lending institution. Even a cursory review of reports issued by securities analysts that covered WaMu, and the transcripts of WaMu's conference calls with securities analysts, reveals that analysts focused on credit losses and loan loss reserves as critical metrics in evaluating the company's financial performance and condition.<sup>1</sup>

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<sup>1</sup> For example, in a report dated October 18, 2007, DA Davidson issued a report that lowered its purchase recommendation to "Underperform" from "Neutral" and observed that "Credit quality deterioration was the big news this quarter, and it appears credit trends will disrupt Q4 results as well" (See Exhibit B). Following the release of WaMu's financial results for the fourth quarter of 2007, Merrill Lynch lowered its estimates of WaMu's earnings and reported that "Credit remains the chief concern, likely delaying the return to profitability until Q2'09, based on our forecast for losses and related provisions" (See Exhibit C).

As in many securities fraud cases, the alleged corrective disclosures are not perfect mirror images of the alleged misstatements. In other words, WaMu never directly admits to either theme of Plaintiffs' fraud claims. Instead, over the second half of 2007 and first half of 2008, WaMu repeatedly disclosed deteriorating financial performance, specifically including substantial credit losses and increases in loan loss reserves. In addition, the New York Attorney General implicated WaMu as participating in fraudulent influence over appraisers. WaMu's stock price reacted negatively to a series of these announcements.

The Complaint clearly identifies dates which Plaintiffs allege represent corrective disclosures (see section titled "The Truth About WaMu's Financial Condition Begins to Emerge"). For example, the Complaint describes that after the close of trading on October 17, 2007, WaMu announced their financial results for the third quarter of 2007. WaMu's quarterly net income fell 72 percent from the same quarter a year earlier. The company cited a weaker housing market and disruptions in the capital markets as the reasons for the decline. As part of the announcement, the Company disclosed that it may have to set aside as much as \$2.9 billion in loan loss provisions, up \$1.2 billion from their July 2007 estimate of \$1.7 billion. WaMu also announced that it would not be increasing its stock dividend for the first time in 12 years. WaMu's stock price responded to the news, by falling 7.71% from \$33.07 per share on October 17, 2007 to \$30.52 per share on October 18, 2007. I have undertaken a preliminary event study and determined that this price movement is highly statistically significant.<sup>2</sup>

An earnings announcement such as this contains a myriad of information and is not simply a revelation that WaMu engaged in fraudulent behavior. However, if Plaintiffs are able to prove, as they allege clearly in the Complaint, that the Company fraudulently withheld information from the market regarding its appraisal practices, underwriting standards and the credit quality of its customers, then there is a coherent economic and logical link between these misstatements and the stock price decline. This is because the foreseeable consequence of

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<sup>2</sup> An event study is a procedure that statistically tests whether a particular change in price is sufficiently large, after controlling for market effects, that simple random variation can be ruled out as the cause of the price movements. In this case, I analyzed WaMu's stock price after controlling for general market movements (using the S&P 500) and industry price movements (using the S&P Supercomposite Banking Index). The change in WaMu's stock price on October 18, 2007, after controlling for market and industry effects, is far greater than the conventional threshold for statistical significance (i.e. less than 5% probability the change in price would occur by chance.)



lending money to less creditworthy individuals than disclosed to the market is, at some point, incurring larger than expected credit losses and the need to record greater loss reserves. The October 17, 2007 announcement specifically reveals substantially greater than expected increases in loss reserves. In my opinion, this portion of the announcement contributed materially to the price decline. This is supported by the comments of securities analysts immediately subsequent to the announcement.<sup>3</sup> This focus on credit losses and loss reserves as important valuation drivers is consistent with my own understanding and experience valuing these types of institutions.

The previous example is just one of a series of alleged corrective disclosures identified in the Complaint, but it highlights the direct and economically coherent loss causation argument Plaintiffs are pleading. The other alleged corrective disclosures are clearly detailed in the complaint and are either specific to the New York Attorney General's investigation of inflated appraisals (e.g. November 1, 2007) or underscore the weakening of WaMu's credit portfolio (e.g. December 11, 2007, March 27, 2008, and April 8, 2008, June 9, 2008). I have not engaged in a detailed analysis to determine whether each and every date included in the Complaint is appropriate, but I have satisfied myself that Plaintiffs' overall loss causation theory is sound.

I am mindful that Defendants may try to argue that some or all of the declines in the stock price on the announcements identified by Plaintiffs, such as the example above, represent losses that would have occurred regardless of the alleged fraud because of broader declines in the housing market and the economy in general. I concur that some fraction of the price decline on at least certain of the dates identified by Plaintiffs are likely due to these outside factors. Fact discovery and further expert analysis in this case will play an important role in understanding what proportion of losses are directly linked to, and a foreseeable consequence of, the alleged fraud and which are not. However, in my opinion, Plaintiffs have provided a coherent

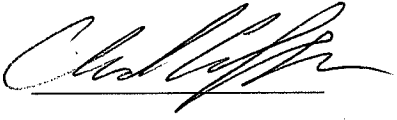
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<sup>3</sup> For example, a Credit Suisse analyst report dated October 18, 2007 stated "We are reducing our 2007 and 2008 EPS estimates to reflect higher loss provisions . . . We remain concerned about the earnings impact of the costs related to higher problem assets and reiterate our Neutral rating" (See Exhibit D). A Merrill Lynch analyst report dated the same day, "Most surprising was the outlook for higher credit costs in Q4'07, \$1.2B, due to the rapidly deteriorating performance of its loan portfolio." The report concludes by stating, "We have lowered our '07 [earnings per share] estimate to \$2.40 from \$2.80, reflecting Q3 Actuals and WM's increased provision guidance. Our '08 estimate has been lowered to \$2.60 from \$3.45. *The revision largely reflects \$3.8[Billion] of provision expenses vs. our prior expectation of \$2.0[Billion]*" (See Exhibit E - emphasis added).

economic theory of how and why the alleged fraud would result in inflated prices for WaMu's securities and specific, logical, and economically coherent theory of causal linkage to information disclosures that resulted in declines in price - and thus losses for WaMu investors.

I declare under penalty of perjury that the aforesaid is true and correct.

Executed in Chicago, Illinois on August 5, 2008

A handwritten signature in black ink, appearing to read "Chad Coffman", written over a horizontal line.

Chad Coffman, CFA

# EXHIBIT A

**CURRICULUM VITAE OF  
CHAD W. COFFMAN**

Winnemac Consulting, L.L.C.  
One South Wacker Drive, Suite 3800  
Chicago, IL 60606  
Mobile: (815) 382-0092  
Email: coffman@winnemac.com

**EMPLOYMENT:**

**Winnemac Consulting, LLC**  
President (2008 - Current)

**Chicago Partners, LLC**  
Principal (2007 – 2008)  
Vice President (2003 – 2007)  
Director (2000 – 2003)  
Senior Associate (1999 – 2000)  
Associate (1997 – 1999)  
Research Analyst (1995 – 1997)

**EDUCATION:**

**C.F.A.** Chartered Financial Analyst, 2003

**M.P.P.** University of Chicago, 1997  
Masters of Public Policy, with a focus in economics including coursework in Finance,  
Labor Economics, Econometrics, and Regulation

**B.A.** Knox College, 1995  
Economics, Magna Cum Laude  
Graduated with College Honors for Paper entitled “Increasing Efficiency in Water  
Supply Pricing: Using Galesburg, Illinois as a Case Study”  
Dean's List Every Term  
Phi Beta Kappa

**SELECTED EXPERIENCE:**

Experience in Securities and Valuation Cases:

- Expert consultant for Citigroup/Salomon Smith Barney in various matters related to Jack Grubman’s analyst coverage of various companies. This included supporting multiple experts at high-profile arbitration where plaintiffs claimed \$900 million in damages. Arbitration panel returned a verdict in favor of client (reported in Wall Street Journal).

**SELECTED EXPERIENCE (CONT.):**

- Expert damages consultant in dozens of 10b-5 and Section 11 securities litigation, including, but not limited to:
  - WorldCom
  - Enron
  - Tyco
  - Parmalat
  - Sears
  - Atlas Air
  - UnumProvident
  - XL Capital
  - Household Finance/HSBC
  - Dynegy
  - Anicom
- Served as neutral expert for mediator (Judge Daniel Weinstein) in multiple 10(b)-5 securities cases as well as futures manipulation case.
- Expert consultant for the American Stock Exchange (AMEX) where I evaluated issues related to multiple listing of options. Performed econometric analysis of various measures of option spread using tens of millions of trades.
- Expert consultant to large hedge fund that owned bonds in WorldCom. Responsible for directing analysis that led to favorable settlement of their claim in the bankruptcy.
- Testifying expert in the matter of Kuo, Steven Wu v. Xceedium Inc, Supreme Court of New York, County of New York, Index No. 06-100836. Filed report re: the fair value of Mr. Kuo's shares.
- Testifying expert in the matter of Pallas, Dennis H. v. BPRS/Chestnut Venture Limited Partnership and Gerald Nudo, Circuit Court of Cook County, Illinois, County Department, Chancery Division. Filed report re: fair value of Pallas shares.

Experience in Labor Economics and Discrimination-Related Cases:

- Expert consultant for Cargill in class action race discrimination matter in which class certification was defeated.
- Expert consultant for 3M in class action age discrimination matter.
- Expert consultant for Wal-Mart in class action race discrimination matter.
- Expert consultant for Novartis regarding various labor related issues.

- Expert consultant on various other significant confidential labor economics matters in which there were class action allegations related to race and gender.

#### **SELECTED EXPERIENCE (CONT.):**

- Expert consultant for Farmers Insurance related to litigation and potential regulation resulting from the use of credit scores in the insurance underwriting process.
- Testifying expert in Shirley Cohens v. William Henderson, Postmaster General, United States Postal Service. United States District Court for the District of Columbia. C.A 1:00CV-1834 (TFH)  
– Filed report re: lost wages and benefits.
- Testifying expert in Richard Akins v. NCR Corporation. Before the American Arbitration Association – Filed report re: lost wages.

#### **Selected Experience in Antitrust, General Damages, and Other Matters:**

- Expert consultant in high-profile, ongoing antitrust matters in the computer and credit card industries.
- Expert consultant for plaintiffs in re: Brand Name Drugs Litigation. Responsible for managing, maintaining and analyzing data totaling over one billion records in one of the largest antitrust cases ever filed in the Federal Courts.
- Served as neutral expert for mediator (Judge Daniel Weinstein) in allocating a settlement in an antitrust matter.
- Expert consultant in Seminole County and Martin County absentee ballot litigation during disputed presidential election of 2000.
- Expert consultant for sub-prime lending institution to determine effect of alternative loan amortization and late fee policies on over 20,000 customers of a sub-prime lending institution. Case settled favorably at trial immediately after the testifying expert presented an analysis I developed showing fundamental flaws in opposing experts calculations.
- Expert consultant to CIB Marine for bank valuation study
- Played significant role in highly-publicized internal accounting investigation of two Fortune 500 companies.

#### **TEACHING EXPERIENCE:**

KNOX COLLEGE, Teaching Assistant - Statistics, (1995)  
KNOX COLLEGE, Tutor in Mathematics, (1992 - 1993)

#### **PUBLICATIONS:**

Coffman, Chad and Mary Gregson, "Railroad Construction and Land Value." *Journal of Real Estate and Finance*, 16:2, 191-204 (1998).

**PROFESSIONAL AFFILIATIONS:**

Associate Member CFA Society of Chicago Partners  
Associate Member CFA Institute  
Phi Beta Kappa

**AWARDS:**

1994 Ford Fellowship Recipient for Summer Research.  
1993 Arnold Prize for Best Research Proposal.  
1995 Knox College Economics Department Award.

**PERSONAL ACTIVITIES:**

Pro bono consulting for Cook County State's Attorney's Office

# EXHIBIT B





D.A. Davidson &amp; Co.

member SIPC

Institutional Equity Research

October 18, 2007

## WASHINGTON MUTUAL, INC.

WM – NYSE

## Rating:

**UNDERPERFORM↓**

Price: (10/17/07) \$33.07

## Price Targets:

12-18 month: \$29↓

5-year: \$36↓

## Industry:

Banks &amp; Thrifts

## Jim Bradshaw

503.603.3022

jbradshaw@dadco.com

## Jeff Rulis

503.603.3025

jrulis@dadco.com

## Katherine Woods-Eliot

Research Associate

503.603.3096

kwoods-eliot@dadco.com

## Company Description:

Seattle, WA – Washington Mutual is the nation's largest thrift with approximately \$330 billion in assets and more than 2,500 banking offices throughout the nation. The company, founded in 1889, offers primarily retail and commercial banking, along with mortgage loans and services.

FY (Dec)	2006A	2007E	Y-O-Y Growth	2008E	Y-O-Y Growth
Revenue (\$B)	\$14.6	\$14.6	0%	\$16.2	11%
Previous	-	\$14.8		\$17.3	
Price/Revenue ratio	2.2x	2.0x		1.8x	
EPS Revised	\$3.64	\$2.35	-35%	\$2.60	10%
Previous	-	\$2.63		\$3.75	
Price/EPS ratio	9.1x	14.1x		12.7x	

Quarterly Data:	EPS	EPS Previous	Revenue (\$B)	Revenue Previous
3/31/07A	\$0.86	-	\$3.6	-
6/30/07A	\$0.92	-	\$3.8	-
9/30/07A	\$0.23	\$0.19	\$3.4	NC
12/31/07E	\$0.32	\$0.66	\$3.8	\$4.1

## Valuation Data

Long-term growth rate (E)	13%
Equity/Assets (9/30/07)	7.5%
Book value per share (9/30/07)	\$27.21
Tangible BV per share (9/30/07)	\$16.78
Dividend (yield)	\$2.24 (6.8%)
Return on Equity (T-T-M)	3.4%

## Trading Data

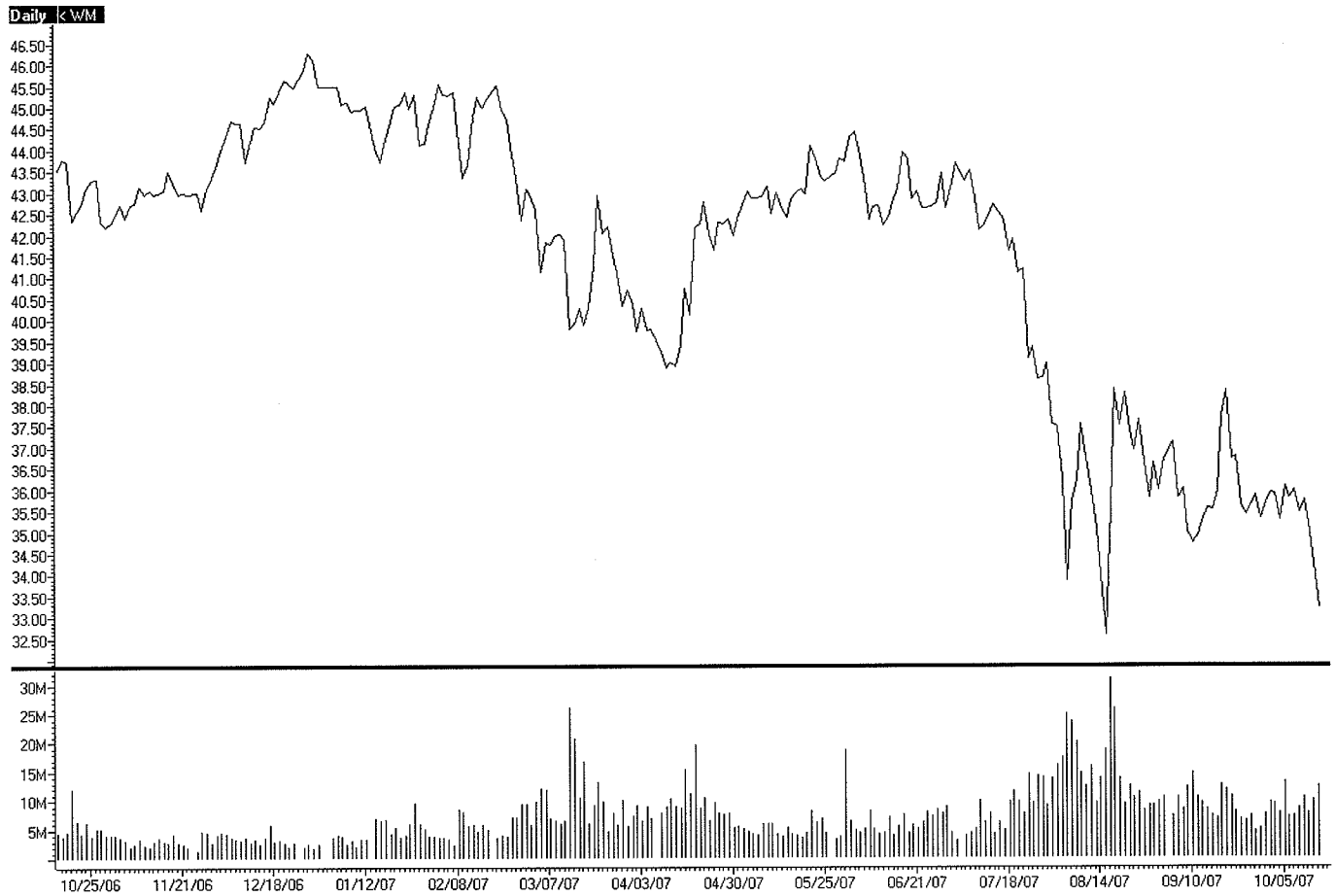
Shares outstanding (M)	876.0
Market Capitalization (\$B)	\$29.0
52-week range	\$31.27 - \$46.38
Average daily volume (3 mos.) (M)	11.6
Float	98%
Index Membership	S&P 500

## Credit Rapidly Softening, Taking A Cautious Approach. Lowering Rating To UNDERPERFORM

- It was a rough quarter for the company with severe credit losses, high mark-to-market and other credit market disruption costs, and a cautious near-term outlook from management. Reported EPS was \$0.23, above our \$0.19 estimate (consensus was a near-meaningless \$0.27, within a range of \$0.19-\$0.83). Operating income was actually worse than we feared, as the company only recorded a 4.5% tax rate in Q3 versus our 37.5% forecast, related to the sharp drop in income.
- Credit quality deterioration was the big news this quarter, and it appears credit trends will disrupt Q4 results as well. The company reported a loan loss provision of \$967 million, just below the \$975 million figure we expected. Non-performing assets increased from \$4.02 billion to \$5.45 billion during the quarter.
- We are sharply lowering our EPS outlook for the company given the uncertainty surrounding asset quality and revenue from home mortgage activities. We were assuming 2007 EPS of \$2.63 and \$3.75 in 2008. We are cutting these forecasts to \$2.35 and \$2.60, respectively. The bulk of the cut is related to rising credit costs.
- We are lowering our price target to \$29 (from \$37) and our rating from Neutral to UNDERPERFORM given lower EPS estimates and our concern about credit quality. The cash dividend offers some support to the share price, and the yield is above 6%. The company does not seem to be in a strong position to support the dividend, fund asset growth, and buyback stock, however. We assume share purchase is off the table for now, suggesting limited support for the stock in the interim.

D.A. Davidson & Co.

### Price Chart



Source: Thomson One

**All Around Rough Quarter**

Washington Mutual reported Q3 EPS of \$0.23, slightly better than the \$0.19 EPS figure we were expecting. The company recently guided net income down about 75% from the Q3:06 figure of \$748 million, causing us to lower our forecast from \$0.72 to \$0.19 per share. Actual reported net income was \$202 million, down about 73%.

It was a rough quarter for the company with severe credit losses, high mark-to-market and other credit market disruption costs, and a cautious near term outlook from management on the conference call following the earnings release. Operating income was actually worse than we feared, as the company only recorded a 4.5% tax rate in Q3 versus our 37.5% forecast, related to the sharp drop in income. Oddly enough, while it felt like a kitchen sink quarter, the company suggested that credit costs in Q4 are likely to rise even further.

**Narrower Spreads, Less Asset Growth Than Assumed**

Spread income was \$2.01 billion during Q3, a drop of \$20 million from Q2. We expected spread income, driven by improved NIM and more rapid balance sheet growth, to be almost \$200 million higher. Instead, NIM fell by 4bp in the quarter, to 2.86%, while we expected margins would rise about 5bp. The high cost of funding asset growth in the quarter, with funding mostly coming from FHLB and other short term borrowings linked to LIBOR, caused margin decay in the quarter. We anticipate that margins will lay flat in Q4 unless funding spreads improve quickly.

Average earning assets increased about \$4 billion in the quarter to \$283 billion while average assets rose about the same. The company shifted a large portion of loans (about \$15 billion) from a held-for-sale category to held-for-investment, recognizing a loss of about \$147 million. While we anticipated the transfer, we also assumed that current quarter production would ultimately end up on the company's balance sheet—but production volume fell sharply, keeping balance sheet growth more subdued than we expected. Home loan production per quarter has fallen from \$41 billion during Q1 to \$36 billion in Q2 to \$26 billion in Q3. Most of the volume has been in conforming residential loans, as sub-prime and non-conforming production has stalled.

**Rapid Decline In Credit Quality**

Credit quality deterioration was the big news this quarter, and it appears credit trends will disrupt Q4 results as well. The company reported a loan loss provision of \$967 million, just below the \$975 million figure we expected. Non-performing assets increased from \$4.02 billion to \$5.45 billion during the quarter, 1.70% of average assets. This is one of the highest ratios in our universe. The company also recorded net loan losses of \$421 million in the quarter, an increase of 55% from the Q2 pace.

The company's commercial loan book is performing well and accounted for only a small piece of the increase in NPAs, but virtually all the home loan categories saw an increase in delinquencies and loss rates. The company anticipates further deterioration in credit quality in Q4 given the rapid decline in home prices in most markets. This leads us to push our Q4 loan loss provision assumption from the \$968 million level noted in Q3 to \$1.25 billion, an increase of \$250 million from our last forecast. This is the fourth time this year we have boosted loss expectations.

The increase in loan totals held in the company's investment portfolio also leads us to forecast higher provision rates in 2008, and we are lifting our loan loss provision assumption from \$2.8 billion to \$3.35 billion in 2008. Until credit markets return to more normal operations and housing prices stabilize, it is difficult to assess near-term loss severity, in our opinion.

**Numerous Mark-To-Market Charges Included In Q3 Results**

Fee income was \$1.4 billion, falling about \$380 million from Q2. In addition to the loss reported above on the loan transfer, the company also noted about \$83 million in charges related to market disruptions in the sale and risk management activities. It also booked a \$153 million mark-to-market loss on various trading assets, including the reduction of the carrying value of credit card and sub-prime residuals. In addition, the company recorded a \$104 million charge related to an impairment of carrying value on investment grade mortgage securities. The positive mark on the company's mortgage servicing rights asset was \$222 million during the quarter, and offset some of the other charges. All of these items, when aggregated, reduced EPS by about \$0.19.

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D.A. Davidson & Co.**Low Tax Rate Helps Q3 EPS By \$0.07**

Operating costs were \$2.2 billion, \$109 million higher than we expected. The company shuttered about 33 branch offices in Q3, but the net headcount figure was higher than we expected. We believe this is a timing issue. The company plans to open 50 new stores in Q4.

The tax rate was just 4.5% in Q3 versus our forecast 37.5% rate. We were expecting operating income of \$288 million for Q3. The reported figure was \$220 million, so operating results were softer than we expected. If the company had paid normal taxes in Q3, EPS would have been \$0.16. The tax rate will revert back to a more normal level in Q4, assuming the company posts profits in line with our revised expectations.

**No Buyback, No Dividend Increase For Now**

The company left the cash dividend at \$0.56 per quarter, breaking a long string of boosting the cash dividend each quarter. Management seems committed to maintaining this base for the time being, and has curtailed repurchasing shares for now. Management expects about \$5 billion in asset growth in Q4. It appears there is sufficient capital to pay the dividend and support modest balance sheet growth for several more quarters, assuming loss rates do not materially ramp past the expected Q4 pace.

**EPS Is Disappearing**

We are sharply lowering our EPS outlook for the company, given the uncertainty surrounding asset quality and revenue from home mortgage activities. We were assuming 2007 EPS of \$2.63 and \$3.75 in 2008. We are cutting these forecasts to \$2.35 and \$2.60, respectively. The bulk of the cut is related to rising credit costs.

**Cutting Rating From Neutral To UNDERPERFORM**

Over the last decade WM shares have traded at an average of 11.5x forward EPS within a range of 6.2x to more than 20x. We believe a forward EPS multiple of 10x-11x is appropriate at this juncture given credit and interest rate risks. This suggests a price target in the range of \$27-\$29 looking out to 2008 EPS. We are lowering our price target to \$29 (from \$37) given lower EPS estimates and our concern about credit quality. The cash dividend offers some support to the share price, and the yield is above 6%. But the company does not seem to be in a strong position to support the dividend, fund asset growth, and buyback stock. We assume share purchase is off the table for now, suggesting limited support for the stock in the interim. We are lowering our rating from Neutral to **UNDERPERFORM**.

Jim Bradshaw  
Senior Research Analyst  
503.603.3022

## D.A. Davidson &amp; Co.

Washington Mutual, Inc.  
Financial Data (In MM's, except PS)  
NYSE:WM FYE Dec

	2005	Q1:06	Q2:06	Q3:06	Q4:06	2006	Q1:07	Q2:07	Q3:07	Q4:07e	2007e	2008e
<b>Income Statement</b>												
Interest Income	\$ 15,919	\$ 4,657	\$ 4,935	\$ 5,105	\$ 5,210	\$ 19,907	\$ 5,008	\$ 4,748	\$ 4,856	\$ 5,078	\$ 19,690	\$ 21,779
Interest Expense	\$ 7,701	\$ 2,540	\$ 2,875	\$ 3,158	\$ 3,212	\$ 11,785	\$ 2,927	\$ 2,714	\$ 2,842	\$ 3,025	\$ 11,508	\$ 12,767
Net Interest Income	\$ 8,218	\$ 2,117	\$ 2,060	\$ 1,947	\$ 1,998	\$ 8,122	\$ 2,081	\$ 2,034	\$ 2,014	\$ 2,053	\$ 8,182	\$ 9,012
Loan Loss Provision	\$ 316	\$ 82	\$ 224	\$ 166	\$ 344	\$ 816	\$ 234	\$ 372	\$ 967	\$ 1,250	\$ 2,823	\$ 3,345
Inc. After Provision	\$ 7,902	\$ 2,035	\$ 1,836	\$ 1,781	\$ 1,654	\$ 7,306	\$ 1,847	\$ 1,662	\$ 1,047	\$ 803	\$ 5,359	\$ 5,667
Depositor Fees	\$ 2,194	\$ 578	\$ 641	\$ 655	\$ 692	\$ 2,566	\$ 665	\$ 720	\$ 740	\$ 761	\$ 2,886	\$ 3,204
Loan Servicing Fees, net	\$ 946	\$ 537	\$ 462	\$ 256	\$ 472	\$ 1,727	\$ 419	\$ 637	\$ 748	\$ 769	\$ 2,573	\$ 2,728
Securities, Annuities & Credit Card Fees	\$ 1,006	\$ 290	\$ 241	\$ 248	\$ 266	\$ 1,045	\$ 261	\$ 282	\$ 305	\$ 311	\$ 1,159	\$ 1,252
Other operating income	\$ 654	\$ 238	\$ 179	\$ 127	\$ 180	\$ 724	\$ 120	\$ 191	\$ 7	\$ 195	\$ 513	\$ 554
Gain on sale of loans	\$ 847	\$ 157	\$ 184	\$ 217	\$ 64	\$ 622	\$ 149	\$ 66	\$ (169)	\$ (125)	\$ (79)	\$ -
Gain on sale of other assets/hedging	\$ (241)	\$ (75)	\$ (129)	\$ 67	\$ (82)	\$ (219)	\$ (73)	\$ (138)	\$ (252)	\$ (125)	\$ (588)	\$ (510)
Total Other Income	\$ 5,406	\$ 1,725	\$ 1,578	\$ 1,570	\$ 1,592	\$ 6,465	\$ 1,541	\$ 1,758	\$ 1,379	\$ 1,787	\$ 6,465	\$ 7,227
Salaries & Benefits	\$ 3,738	\$ 1,044	\$ 1,021	\$ 939	\$ 945	\$ 3,949	\$ 1,002	\$ 977	\$ 910	\$ 880	\$ 3,769	\$ 3,930
Net Occupancy & Equipment	\$ 1,523	\$ 392	\$ 435	\$ 408	\$ 476	\$ 1,711	\$ 376	\$ 354	\$ 371	\$ 355	\$ 1,456	\$ 1,614
Regulatory Assessments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DP Fees	\$ 451	\$ 135	\$ 145	\$ 142	\$ 133	\$ 555	\$ 129	\$ 132	\$ 135	\$ 138	\$ 534	\$ 566
Other operating expense	\$ 2,106	\$ 625	\$ 650	\$ 714	\$ 722	\$ 2,711	\$ 626	\$ 702	\$ 775	\$ 755	\$ 2,858	\$ 3,029
Non-recurring Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Amort. of Goodwill & CDI	\$ 52	\$ 15	\$ 15	\$ 15	\$ 15	\$ 60	\$ 15	\$ 15	\$ 15	\$ 15	\$ 60	\$ 60
RE owned operations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Other Expenses	\$ 7,870	\$ 2,211	\$ 2,266	\$ 2,218	\$ 2,291	\$ 8,986	\$ 2,148	\$ 2,180	\$ 2,206	\$ 2,143	\$ 8,677	\$ 9,200
Income B4 Taxes	\$ 5,438	\$ 1,549	\$ 1,148	\$ 1,133	\$ 955	\$ 4,785	\$ 1,240	\$ 1,240	\$ 220	\$ 446	\$ 3,146	\$ 3,694
Accounting Changes, Net	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Applicable Taxes	\$ 2,006	\$ 564	\$ 389	\$ 394	\$ 315	\$ 1,662	\$ 456	\$ 410	\$ 10	\$ 154	\$ 1,030	\$ 1,385
Net Income	\$ 3,432	\$ 985	\$ 759	\$ 739	\$ 640	\$ 3,123	\$ 784	\$ 830	\$ 210	\$ 292	\$ 2,116	\$ 2,309
Extraordinary/Discontinued Item, Net	\$ -	\$ -	\$ 8	\$ 9	\$ 418	\$ 435	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Income After Extraordinary	\$ 3,432	\$ 985	\$ 767	\$ 748	\$ 1,058	\$ 3,558	\$ 784	\$ 830	\$ 210	\$ 292	\$ 2,116	\$ 2,309
Income Attributable to Common	\$ 3,432	\$ 985	\$ 767	\$ 748	\$ 1,050	\$ 3,550	\$ 777	\$ 822	\$ 202	\$ 285	\$ 2,086	\$ 2,281
<b>Avg Shares Outstanding (FD)</b>												
EPS (FD)	\$ 3.73	\$ 0.98	\$ 0.79	\$ 0.77	\$ 1.10	\$ 3.64	\$ 0.86	\$ 0.92	\$ 0.23	\$ 0.32	\$ 2.35	\$ 2.60
Dividends Per Share	\$ 1.90	\$ 0.50	\$ 0.51	\$ 0.52	\$ 0.53	\$ 2.06	\$ 0.54	\$ 0.55	\$ 0.56	\$ 0.56	\$ 2.21	\$ 2.24
Payout Ratio	50.9%	50.9%	64.9%	67.3%	48.2%	56.6%	62.5%	59.8%	242.9%	172.4%	93.9%	86.2%
Book Value Per Share	\$ 27.95	\$ 27.45	\$ 27.66	\$ 28.17	\$ 28.21	\$ 28.21	\$ 27.30	\$ 27.27	\$ 27.21	\$ 26.97	\$ 26.97	\$ 27.33
Tangible Book Value Per Share	\$ 19.60	\$ 18.80	\$ 19.00	\$ 19.32	\$ 18.74	\$ 18.74	\$ 17.11	\$ 16.93	\$ 16.78	\$ 16.54	\$ 16.54	\$ 16.90
<b>Balance Sheet (Avg Balances)</b>												
Investments & other earning assets	\$ 34,567	\$ 45,499	\$ 46,369	\$ 44,995	\$ 44,370	\$ 45,308	\$ 37,636	\$ 37,607	\$ 42,571	\$ 42,997	\$ 40,203	\$ 45,147
Loans, Net	\$ 260,197	\$ 262,326	\$ 266,870	\$ 267,832	\$ 270,414	\$ 266,861	\$ 258,064	\$ 242,229	\$ 240,692	\$ 243,099	\$ 246,021	\$ 255,254
Total Earning Assets	\$ 294,764	\$ 307,825	\$ 313,239	\$ 312,827	\$ 314,784	\$ 312,169	\$ 295,700	\$ 279,836	\$ 283,263	\$ 286,096	\$ 286,224	\$ 300,400
Total Assets	\$ 326,560	\$ 344,562	\$ 349,561	\$ 349,542	\$ 353,056	\$ 349,180	\$ 331,905	\$ 316,004	\$ 320,475	\$ 323,680	\$ 323,016	\$ 339,864
Checking	\$ 46,545	\$ 40,436	\$ 37,603	\$ 34,866	\$ 33,098	\$ 36,501	\$ 31,821	\$ 30,373	\$ 28,492	\$ 28,634	\$ 29,830	\$ 30,066
MMDA	\$ 42,549	\$ 44,816	\$ 48,095	\$ 49,144	\$ 53,314	\$ 48,842	\$ 54,862	\$ 58,969	\$ 57,377	\$ 57,664	\$ 57,218	\$ 60,547
Time CD's	\$ 62,107	\$ 73,182	\$ 79,541	\$ 90,001	\$ 93,415	\$ 84,035	\$ 91,631	\$ 84,330	\$ 80,719	\$ 81,123	\$ 84,451	\$ 85,179
Sec Sold under Repo	\$ 20,673	\$ 22,743	\$ 25,690	\$ 23,058	\$ 18,958	\$ 22,612	\$ 15,944	\$ 10,585	\$ 11,608	\$ 11,666	\$ 12,451	\$ 12,249
Advances from FHLB	\$ 68,703	\$ 66,995	\$ 60,862	\$ 52,886	\$ 46,005	\$ 56,687	\$ 36,051	\$ 22,063	\$ 34,128	\$ 34,299	\$ 31,635	\$ 36,014
Other Borrowings	\$ 21,585	\$ 26,636	\$ 26,239	\$ 27,815	\$ 34,420	\$ 28,778	\$ 32,808	\$ 39,886	\$ 40,567	\$ 40,770	\$ 38,508	\$ 42,808
Total Int-Bearing Liabilities	\$ 262,162	\$ 274,808	\$ 278,030	\$ 277,770	\$ 279,210	\$ 277,455	\$ 263,117	\$ 246,206	\$ 252,891	\$ 254,155	\$ 254,092	\$ 266,863
Stockholders Equity	\$ 23,454	\$ 27,798	\$ 26,932	\$ 26,147	\$ 26,700	\$ 26,894	\$ 24,407	\$ 24,436	\$ 23,994	\$ 24,137	\$ 24,243	\$ 25,277
Net Chargeoffs	\$ 244	\$ 105	\$ 116	\$ 154	\$ 136	\$ 511	\$ 183	\$ 271	\$ 421	\$ 939	\$ 1,814	\$ 2,745
NCO/Avg. Loans	0.09%	0.16%	0.17%	0.23%	0.20%	0.19%	0.28%	0.45%	0.70%	1.55%	0.74%	1.08%
Loan Loss Reserve	\$ 1,695	\$ 1,642	\$ 1,663	\$ 1,550	\$ 1,630	\$ 1,630	\$ 1,540	\$ 1,560	\$ 1,889	\$ 2,200	\$ 2,200	\$ 2,800
LLR/End Period Loans	0.74%	0.68%	0.68%	0.64%	0.72%	0.72%	0.71%	0.73%	0.80%	0.91%	0.91%	1.05%
Non-Performing Loans (N/A & Restr)	\$ 1,708	\$ 1,752	\$ 1,850	\$ 2,006	\$ 2,313	\$ 2,313	\$ 2,688	\$ 3,275	\$ 4,577	\$ 5,500	\$ 5,500	\$ 6,500
OREO & Repo'd Property	\$ 276	\$ 309	\$ 330	\$ 405	\$ 480	\$ 480	\$ 587	\$ 750	\$ 874	\$ 1,000	\$ 1,000	\$ 1,250
Total Non-Performing Assets	\$ 1,984	\$ 2,061	\$ 2,180	\$ 2,411	\$ 2,793	\$ 2,793	\$ 3,275	\$ 4,025	\$ 5,451	\$ 6,500	\$ 6,500	\$ 7,750
NPA/Avg TA	0.61%	0.60%	0.62%	0.69%	0.79%	0.80%	0.99%	1.27%	1.70%	2.01%	2.01%	2.28%
LLR/Non-performing Loans	99.24%	93.72%	89.89%	77.27%	70.47%	70.47%	57.29%	47.63%	41.27%	40.00%	40.00%	43.08%
NPA/Equity & Reserves	7.89%	7.00%	7.62%	8.70%	9.86%	9.79%	12.62%	15.48%	21.06%	24.68%	24.58%	27.60%
NIM (FTE)	2.80%	2.75%	2.65%	2.53%	2.58%	2.60%	2.79%	2.90%	2.86%	2.87%	2.86%	3.00%
Avg Rate on Earning Assets	5.38%	6.07%	6.30%	6.51%	6.60%	6.37%	6.81%	6.79%	6.84%	7.10%	6.89%	7.25%
Cost of Funds Supporting Assets	2.58%	3.32%	3.65%	3.98%	4.02%	3.77%	4.02%	3.89%	3.98%	4.23%	4.03%	4.25%
Efficiency ratio	57.77%	57.55%	62.29%	63.07%	63.82%	61.60%	59.30%	57.49%	65.02%	55.82%	59.25%	56.65%
ROAA	1.05%	1.14%	0.88%	0.86%	1.19%	1.02%	0.94%	1.04%	0.25%	0.35%	0.65%	0.67%
ROE	14.63%	14.17%	11.39%	11.44%	15.73%	13.20%	12.73%	13.46%	3.37%	4.73%	8.61%	9.02%
Avg Equity/Avg TA	7.18%	8.07%	7.70%	7.48%	7.56%	7.70%	7.35%	7.73%	7.49%	7.46%	7.51%	7.44%
<b>Loan Portfolio</b>												
Residential	\$ 135,290	\$ 144,001	\$ 145,701	\$ 141,185	\$ 118,204	\$ 118,204	\$ 111,061	\$ 106,145	\$ 123,145	\$ 125,682	\$ 125,682	\$ 138,250
Residential Construction	\$ 2,037	\$ 2,095	\$ 2,082	\$ 2,077	\$ 2,082	\$ 2,082	\$ 2,071	\$ 2,058	\$ 2,110	\$ 2,153	\$ 2,153	\$ 2,369
Commercial Real Estate	\$ 30,636	\$ 31,504	\$ 32,286	\$ 33,276	\$ 36,906	\$ 36,906	\$ 36,243	\$ 36,169	\$ 39,166	\$ 39,973	\$ 39,973	\$ 43,970
Mfg Housing, 2nd's, & Consumer	\$ 51,489	\$ 52,474	\$ 53,268	\$ 54,645	\$ 55,200	\$ 55,200	\$ 56,384	\$ 58,874	\$ 62,055	\$ 63,333	\$ 63,333	\$ 69,667
Credit Card	\$ 8,043	\$ 7,906	\$ 8,451	\$ 8,807	\$ 10,861	\$ 10,861	\$ 9,490	\$ 9,913	\$ 8,791	\$ 9,123	\$ 9,123	\$ 10,583
Commercial	\$ 2,137	\$ 2,024	\$ 1,715	\$ 1,775	\$ 1,707	\$ 1,707	\$ 1,772	\$ 1,835	\$ 1,865	\$ 1,903	\$ 1,903	\$ 2,094
Total	\$ 229,632	\$ 240,004	\$ 243,503	\$ 241,765	\$ 224,960	\$ 224,960	\$ 217,021	\$ 214,994	\$ 237,132	\$ 242,168	\$ 242,168	\$ 266,932

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D.A. Davidson & Co. expects to receive, or intends to seek, compensation for investment banking services from this company in the next three months.

D.A. Davidson & Co. is a full service investment firm that provides both brokerage and investment banking services. Jim Bradshaw, Jeff Rulis, and Katherine Woods-Eliot, the research analysts principally responsible for the preparation of this report, will receive compensation that is based upon (among other factors) D.A. Davidson & Co.'s investment banking revenue. However, D.A. Davidson & Co.'s analysts are not directly compensated for involvement in specific investment banking transactions.

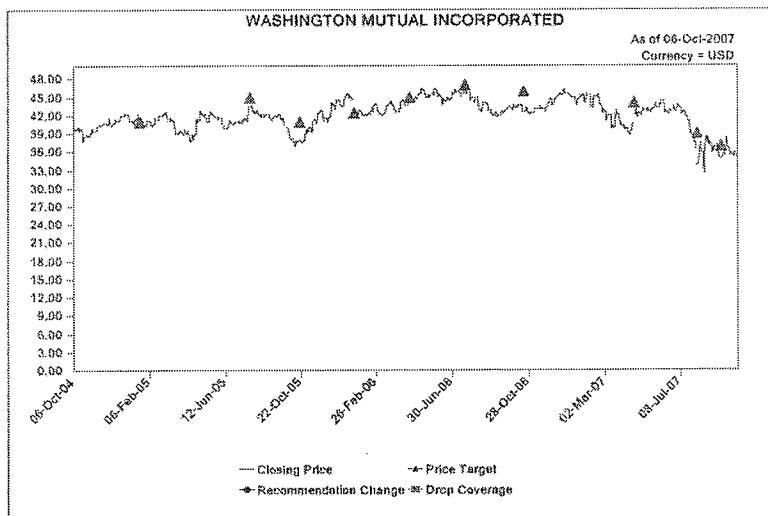
We, Jim Bradshaw, Jeff Rulis, and Katherine Woods-Eliot, attest that (i) all the views expressed in this research report accurately reflect our personal views about the common stock of the subject company, and (ii) no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

**Ratings Information**

D.A. Davidson & Co. Ratings	Buy	Neutral	Underperform
Risk adjusted return potential	Over 15% total return expected on a risk adjusted basis over next 12-18 months	>0-15% return potential on a risk adjusted basis over next 12-18 months	Likely to remain flat or lose value on a risk adjusted basis over next 12-18 months

Distribution of Ratings (as of 9/30/07)	Buy	Hold	Sell
Corresponding Institutional Research Ratings and Distribution	Buy 38%	Neutral 57%	Underperform 5%
Corresponding Private Client Research Ratings and Distribution	Outperform 52%	Market Perform 40%	Underperform 8%
Distribution of Combined Ratings	40%	54%	6%

Distribution of companies from whom D.A. Davidson & Co. has received compensation for investment banking services in last 12 mos.			
Institutional Coverage	6%	3%	0%
Private Client Coverage	0%	10%	0%
Distribution of Combined Investment Banking	5%	3%	0%



**D.A. Davidson & Co. Institutional Research Rating Scale (maintained since 7/9/02)**  
Buy, Neutral, Underperform

WASHINGTON MUTUAL INCORPORATED

Currency = USD

Date	Closing Price	Recommendation Change	Date	Closing Price	Price Target
10-Sep-2007	34.74		10-Sep-2007	34.74	37.00
02-Aug-2007	36.24		02-Aug-2007	36.24	39.00
17-Apr-2007	40.13		17-Apr-2007	40.13	44.00
19-Oct-2006	42.35		19-Oct-2006	42.35	46.00
19-Jul-2006	46.42		19-Jul-2006	46.42	47.00
18-Apr-2006	44.44		18-Apr-2006	44.44	45.00
18-Jan-2006	44.41		18-Jan-2006	44.41	42.50
19-Oct-2005	37.90		19-Oct-2005	37.90	41.00
22-Jul-2005	43.54		22-Jul-2005	43.54	45.00
20-Jan-2005	42.17		20-Jan-2005	42.17	41.00



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Target prices are our Institutional Research Department's evaluation of price potential over the next 12-18 months and 5 years, based upon our assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

### **Other Disclosures**

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# EXHIBIT C



Washington Mutual Inc

# Reiterate sell, No end in sight

Earnings Review

**SELL**Equity | United States | Savings & Loans/Thriffs  
18 January 2008**Merrill Lynch**

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## Q4'07 loss worse than expected; Credit issues will linger

WM reported a Q4'07 EPS loss of \$2.19, below our -\$1.95 forecast, due to losses on trading and AFS securities. Credit remains the chief concern, likely delaying the return to profitability until Q2'09, based on our forecast for losses and related provisions. Maintain Sell rating. WM shares likely to remain under pressure as credit continues to erode and visibility is poor. Take-out seems unlikely, given uncertainty surrounding asset valuations despite strong deposit franchise value.

## Credit deteriorates further; No turn in sight

Credit erosion accelerated in the quarter and looks to be elevated through 2009, if not longer. Losses were 1.22% loans held for investment, up 51 bps from Q3'07, while NPAs were 2.17% vs. 1.65%. Reserves were 1.05% of loans and appear inadequate, in our view, as losses likely will grow in WM's credit card, 2<sup>nd</sup> lien, sub-prime and recent vintage pay-option ARM portfolios.

## Lowering EPS estimates on credit

Lowering EPS forecast due to higher credit charges. '08e goes to -\$1.20 p.s. from -\$0.12 and taking '09e to +\$0.80 from +\$2.70. WaMu continues to build reserves to improve its balance sheet strength and ease regulatory concerns, though we suspect investors remain skeptical about the value of WaMu balance sheet as housing values fall and losses build. Tangible BV of ~\$16 p.s. remains under-pressure, in our view, as additional losses suggests YE'08 of about \$14.30 p.s.

## Maintain Sell

The possible downside from problem credits is high and fundamentals are still deteriorating. We forecast GAAP losses through Q1'09 and investors are likely to question the value of WaMu's balance sheet, suggesting the meaningful discount to BV is warranted. Distressed financials typically witness trough multiples below 75% of BV, suggesting further downside risk to WM. Given WM's weak balance sheet and systemic issues in the mortgage market, a take-out seems unlikely in the near-term, despite the value in WM's retail franchise.

### Estimates (Dec)

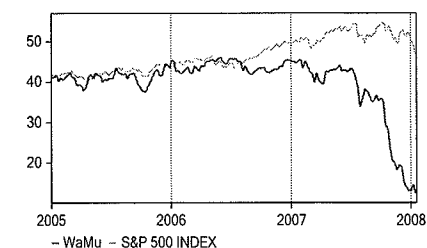
(US\$)	2006A	2007A	2008E	2009E	2010
EPS	3.64	(0.09)	(1.10)	0.80	NA
GAAP EPS	3.64	(0.09)	(1.10)	0.80	NA
EPS Change (YoY)	-2.4%	NM	NM	NM	NA
Consensus EPS (First Call: 14-Jan-2008)			(0.42)	1.46	1.72
Dividend Rate	2.06	1.80	1.80	0.60	NA

### Valuation (Dec)

	2006A	2007A	2008E	2009E	2010
P/E	3.4x	NM	NM	15.6x	NA
GAAP P/E	3.4x	NM	NM	15.6x	NA
Dividend Yield	16.5%	14.4%	14.4%	4.8%	NA

### Stock Data

Price	US\$12.46
Investment Opinion	B-3-8
Volatility Risk	MEDIUM
52-Week Range	US\$10.73-45.81
Mrkt Val / Shares Out (mn)	US\$10,825 / 868.8
ML Symbol / Exchange	WM / NYS
Bloomberg / Reuters	WM US / WM.N
ROE (2008E)	-4.0%
Total Dbt to Cap (Dec-2007A)	92.4%
Est. 5-Yr EPS / DPS Growth	10.0% / 8.0%



### Quarterly Earnings Estimates

	2007	2008
Q1	0.85A	-0.29E
Q2	0.91A	-0.28E
Q3	0.22A	-0.30E
Q4	-2.19A	-0.23E

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Refer to important disclosures on page 6 to 7. Analyst Certification on page 5.

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Washington Mutual Inc

# *iQprofile*<sup>SM</sup> Washington Mutual Inc

## Income Statement Data (Dec)

(US\$ Millions)	2006A	2007A	2008E	2009E	2010
Net Interest Income	8,122	8,176	8,602	9,019	NA
% change	3.0%	0.7%	5.2%	4.8%	NA
Net Fee Income	2,907	3,270	3,651	3,865	NA
Securities Gains / (Losses)	(9)	(318)	120	120	NA
Total Operating Income	14,523	14,219	15,668	16,789	NA
Operating Expenses	(8,728)	(10,562)	(8,049)	(8,225)	NA
% change	10.9%	21.0%	-23.8%	2.2%	NA
Provisions Expense	(816)	(3,107)	(8,404)	(6,893)	NA
% change	270.9%	280.8%	170.5%	-18.0%	NA
Operating Pre-Tax Income	4,979	550	(784)	1,671	NA
Operating Net Income to Comm S/Hold.	3,317	128	(781)	864	NA
GAAP Net Income	3,553	(75)	(953)	692	NA

## Company Description

Washington Mutual Inc. (WM) is the largest US thrift-holding company and third-largest residential mortgage lender. WM is principally focused on mortgage lending/ servicing, and consumer/commercial banking, and operates more than 2600 branches nationally.

## Stock Data

Average Daily Volume	43,541,392
Brokers Covered (FirstCall)	17

## Balance Sheet Data (Dec)

(US\$ Millions)	2006A	2007A	2008E	2009E	2010
Total Assets	346,288	327,913	322,678	322,758	NA
Average Interest Earning Assets	309,204	283,730	289,124	290,935	NA
Total Gross Customer Loans	268,300	247,218	247,362	247,658	NA
% change	2.6%	-7.9%	0.1%	0.1%	NA
Total Customer Deposits	213,956	181,926	209,741	209,793	NA
% change	10.8%	-15.0%	15.3%	0%	NA
Tangible Equity	18,076	17,297	15,823	15,907	NA
Common Shareholders' Equity	27,126	24,584	23,110	23,194	NA

## Key Metrics (Dec)

(US\$ Millions)	2006A	2007A	2008E	2009E	2010
Net Interest Margin	2.63%	2.88%	2.98%	3.10%	NA
Effective Tax Rate	33.4%	70.9%	40.2%	29.6%	NA
Loan / Deposit Ratio	125.4%	135.9%	117.9%	118.0%	NA
Tangible Common Equity / Assets	5.2%	5.3%	4.9%	4.9%	NA
ROA	1.0%	0%	-0.3%	0.2%	NA
ROE	12.9%	-0.3%	-4.0%	3.0%	NA
RoTE	19.7%	-0.4%	-6.0%	4.4%	NA
Dividend Payout Ratio	58.9%	1,215.1%	NA	70.4%	NA
Efficiency Ratio (Cost / Income Ratio)	60.1%	72.7%	51.8%	49.3%	NA

## Quality of Earnings (Dec)

(US\$ Millions)	2006A	2007A	2008E	2009E	2010
Total Non-Interest Inc / Operating Inc	44.1%	42.5%	45.1%	46.3%	NA
NPLs plus Foreclosed Real Estate / Loans	0%	0%	0%	0%	NA
Loan Loss Reserves / NPLs	-0.61%	-1.04%	-2.28%	-2.69%	NA
Loan Loss Reserves / Total Loans	-0.60%	-1.03%	-2.23%	-2.62%	NA

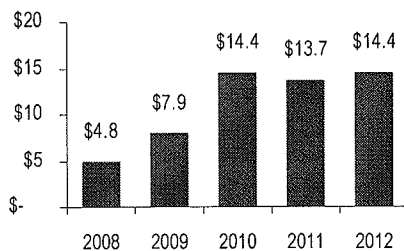


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**Q4'07 Key takeaways:**

- Shortfall to our estimates driven by losses in trading/AFS portfolio
- Credit continues to deteriorate; WM remains under-reserved
- Capital ratios supported by recent preferred offering; Should help forego "must-sell" scenario
- Buyers to remain reluctant as credit environment continues to erode and asset valuations remain at risk

**Chart 1: POAs mostly reset after '09**

Source: Company Presentation

**Q4 loss worse than expected; Maintain Sell**

WaMu reported a \$2.19 p.s. loss in Q4'07, \$0.24 p.s. below our \$1.95 p.s. loss estimate. WaMu pre-announced credit provisions in December, which accounted for most of the loss, though the downside to our forecast is due to impairments to WM's trading and available-for-sale securities portfolio. The losses included 1) \$159M related to retained interest in credit card securitizations 2) \$261M write down of securities and 3) \$83M of trading losses by WM's broker-dealer.

As expected, Q4 results highlighted further deterioration in the credit environment and WM's relatively weak reserve. Excluding credit card related balances, NCOs and NPAs increased to 1.11% and 3.00% of related loans, while reserves finished at only 0.73%. This equates to a coverage ratio of just 0.24x NPAs. We expect reserve building will create further EPS headwinds in 2008, with a return to profitability unlikely until 2009. Based on recent data, we are beginning to think this credit cycle may have an even a longer tail than we previously thought. The majority of WM's pay-option ARMs are expected to reset after '09 (see Chart 1).

**Maintain Sell; Take-out seems unlikely for now**

We continue to rate WM shares Sell. At roughly 0.75x tangible common book value of ~\$16 p.s. (TBV excluding preferred equity), WM shares remain over-valued, in our view, given that BV is positioned to erode. Troubled financials historically witness trough valuations of 0.65x – 0.75x TBV, largely due to the uncertainty of BV, suggesting further downside risk to WM shares. Valuations are likely will remain at sizeable discounts to cycle norms, until there is better visibility into the bottom of the housing market and WaMu's ability to navigate the current capital markets disruption.

A take-out does not seem likely in the near-term, in our view, despite heightened speculation. While WM has an attractively positioned retail footprint, the high level of uncertainty regarding asset valuations likely will leave buyers on the sidelines until the market shows signs of stability. Further, WM is not in a must sell position, in our view, as its deposit franchise and recent capital raises appear adequate enough to support WM's operations for the foreseeable future. However, if the operating environment worsens, a sale could become a more obvious choice to remedy the pain inflicted by the sins of the past.

**Credit cards add to the quarter; Losses to rise**

WM's credit card segment continues to contribute positively to earnings, though rising credit costs likely will impede growth through 2008. The card segment added \$0.11 p.s. to Q4'07 earnings, posting a 2.49% return on average owned assets. Related credit losses finished at 3.57% of average owned balances, down from 3.78% in Q3. Despite the slow down of losses, WM added \$161M to the credit card reserves in expectation of higher losses in '08 and suggested its cards segment could witness losses in the range of 8.5% - 9.5%. This is well above industry norms of 6%, suggesting WaMu is bracing for meaningful credit erosion in light of the portfolio's unproven experience through a credit cycle.

**Revising EPS lower**

We lowered our '08 EPS estimate to -\$1.10 from -\$0.12 and our '09 EPS estimate to \$0.80 from \$2.70. The revisions are a result of increased credit costs, which we now will approximate \$15B through 2009 on roughly \$11B in losses. We think a substantial reserve will remain in 2010, in anticipation of pay-option arm resets.



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**Spread income up 7% (alq) on higher asset base:** Earning assets grew 7% from Q3 while NIM compressed 1 bp on lower asset yields. Expect modest NIM compression in '08 as funding costs subside.

**Provisions up on further credit deterioration:** Provision expense finished at \$1.5B in Q4, up from \$967M in Q3. NCOs finished at 1.22% of loans, up 51 bps, and NPAs increased 52 bps to 2.17% of assets. Expect higher provisions to continue in '08 as credit metrics continue to worsen.

**Non-interest income down on impairments and lower contribution from credit cards:** Non-int inc fell 4% (ann.) from Q3. \$528M of losses on trading and for-sale assets comprised the majority of the miss. Credit cards contributed \$589M in the quarter, down from \$627M in Q3.

**Non-interest expense up largely on goodwill impairment and 1x restructuring costs:** Core non-int expense was up 10% (ann.) from Q3 due to higher occupancy expense and increased expenses related to foreclosed assets.

**Tangible common book fell to \$16.25 p.s., down from \$16.54 p.s. in Q3:** Tier 1 capital, however, improved due to preferred equity issuance, finishing at 6.84% of average total assets and 7.02% of adjusted total assets

Table 1: WM Q4'07 earnings variance table

	Q4'07	Variance		Q4'07-E	New Estimates	
		\$	%		2008-E	2009-E
Avg. Earning Assets	\$ 287,690	-0.2%	-0.2%	\$ 288,357	\$ 289,124	\$ 290,935
NIM	2.85%	-1.0 bp		2.86%	2.98%	3.10%
Net Interest Income	2,047	-0.7%	-0.7%	2,062	8,602	9,019
Provision Expense	(1,534)	-6.2%	-6.2%	(1,635)	(8,404)	(6,893)
SFR Mortgage Bank Inc.	358	37.5%	37.5%	260	1,074	1,131
Credit Card Services	589	0.5%	0.5%	586	1,741	2,174
Deposit & Banking Fees	769	0.4%	0.4%	766	3,223	3,418
Total Noninterest Income	1,365			(537)	7,066	7,770
Compensation & Benefits	(877)	-22.4%	22.4%	(1,130)	(3,210)	(3,200)
Occupancy & Equipment	(488)	29.6%	29.6%	(377)	(1,327)	(1,319)
Total Noninterest Exp.	(4,166)	75.3%	75.3%	(2,376)	(8,049)	(8,225)
Pretax Income	(2,353)	-7.3%	-7.3%	(2,539)	(956)	1,499
GAAP Net Income	(1,867)	9.7%	9.7%	(1,701)	(641)	1,004
GAAP EPS	\$ (2.19)	12.5%	12.5%	\$ (1.95)	\$ (1.10)	\$ 0.80
Key Metrics:					0	0
ROAE	-36.69%			-31.87%	-3.22%	5.25%
ROAA	-2.27%			-2.08%	-0.20%	0.31%
Efficiency Ratio	122.10%			155.84%	51.37%	48.99%
Tan. Equity / Assets	6.61%	1.2 bp		6.60%	0.00%	0.00%
BVPS	\$28.49	-0.2%	-0.2%	\$28.54	\$26.78	\$26.88
TBVPS	\$15.97	-7.3%	-7.3%	\$17.22	\$14.31	\$14.41

Source: Company Reports &amp; Merrill Lynch Research



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## Analyst Certification

I, Kenneth Bruce, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	$\text{Market Cap.} = \text{Current Share Price} * \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	$\text{Basic EBIT} + \text{Depreciation} + \text{Amortization}$

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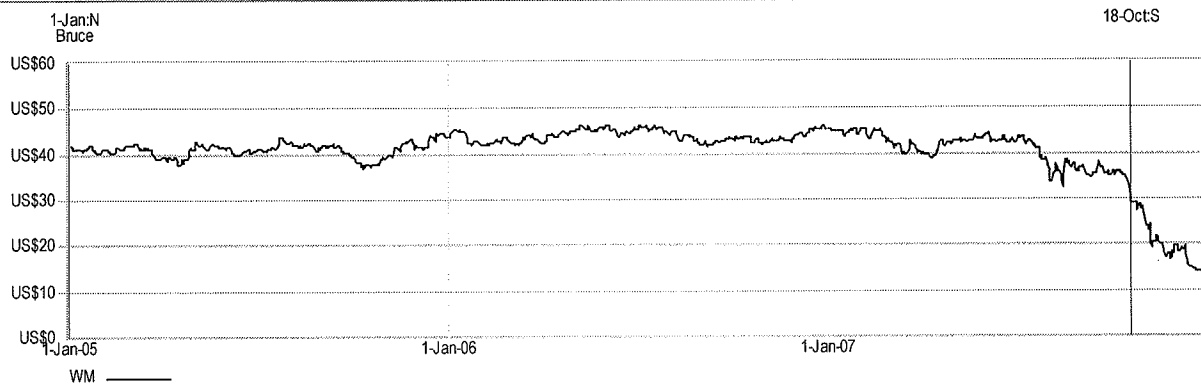


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## Important Disclosures

WM Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of December 31, 2007 or such later date as indicated.

### Investment Rating Distribution: Financial Services Group (as of 01 Jan 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	40.33%	Buy	47	39.83%
Neutral	161	52.79%	Neutral	74	48.37%
Sell	21	6.89%	Sell	6	28.57%

### Investment Rating Distribution: Global Group (as of 01 Jan 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1714	46.25%	Buy	445	29.10%
Neutral	1653	44.60%	Neutral	454	30.55%
Sell	339	9.15%	Sell	67	21.82%

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# EXHIBIT D





18 October 2007  
Americas/United States  
**Equity Research**  
Mortgage Finance / MARKET WEIGHT

## Washington Mutual Inc. (WM)

Rating **NEUTRAL\***  
Price (17 Oct 07) 33.07 (US\$)  
Target price (12M) 35.00 (US\$)  
52 week high - low 46.29 - 32.57  
Market cap. (US\$ m) 29,534.49

\* Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

### Research Analysts

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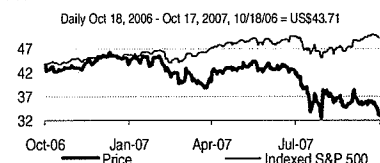
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### EARNINGS

## NPAs and Provisions Rising

- WaMu reported Q3 EPS of \$0.23, \$0.04 above our estimate and \$0.04 below consensus. A lower tax rate added about \$0.12 to headline EPS. The quarter included \$300 million of write-downs partially offset by a \$222 million write-up of the MSR (about \$0.06 per share net). The company announced a \$0.56 quarterly dividend, flat with 2Q. However, if the challenging operating environment persists into early 2008, we believe WaMu may have to re-examine its dividend policy.
- We continue to be concerned by the rate of credit deterioration across a number of WaMu's portfolios, which will likely constrain earnings for the remainder of 2007 and into 2008. Nonperforming assets climbed another 35% in the quarter to nearly \$5.5 billion. Given that the reserve only grew \$330 million coverage of NPLS fell sharply to 41% from 48% in the second quarter. The increase in NPAs was about \$500 million more than we had expected, and we would expect that the pace of increase will remain high. WaMu raised its Q4 loss provision guidance by another \$300 million to \$1.1-1.3 billion, a full year provision nearly 2x their guidance at mid-year.
- Capital levels declined 46 bps to 5.61% as assets grew and earnings didn't cover the dividend. Based upon company guidance we estimate capital is likely to decline about another 20 bps in Q4.
- We are reducing our 2007 and 2008 EPS estimates to reflect higher loss provisions to \$2.35 and \$3.00. Our estimates already contemplated margin expansion and better mortgage banking profitability in 2008. The company will likely give 2008 guidance at its November 7<sup>th</sup> analyst day. We remain concerned about the earnings impact of the costs related to higher problem assets and reiterate our Neutral rating.

### Share price performance



On 10/17/07 the S&P 500 index closed at 1,541.24.

Quarterly EPS	Q1	Q2	Q3	Q4
2006A	0.98	0.79	0.77	1.10
2007E	0.86	0.92	0.23	0.34
2008E				

### Financial and valuation metrics

Year	12/06A	12/07E	12/08E	
EPS (CS adj., US\$)	3.64	2.35	3.00	
Prev. EPS (US\$)		2.45	3.15	
P/E (x)	9.1	14.1	11.0	
P/E rel. (%)	54.6	87.3	75.8	
Revenue (US\$ m)	14,500.0	14,702.5	16,414.2	
OCFPS (US\$)	—	—	—	
P/OCF (x)	—	—	—	
P/BV (x)	1.2	1.2	1.2	
ROE	13.1%	8.7%	11.6%	
Number of shares (m)	893.09	Dividend (current, US\$)		2.20
BV/share (12/06A, US\$)	28.21	Dividend yield		6.7%
P/BV (x)	1.2			—

Source: Company data, Credit Suisse estimates.

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**Exhibit 1: WaMu's Q307 Earnings Highlights**

US\$ in millions, unless otherwise stated

	Q3:06	Q2:07	Q3:07	Q3:07E	Actual vs. Estimate	% change from prior	
						Year	Quarter
<b>Income Statement</b>							
Net Interest income	1,947	2,034	2,014	2,026	-1%	3%	-1%
Non-interest income	1570	1758	1,379	1,430	-4%	-12%	-22%
Non-interest expense	2,184	2,138	2,153	2,148	0%	-1%	1%
Provision	166	372	967	975	-1%	483%	160%
Net Income	748	830	210	175	20%	-72%	-75%
EPS	\$ 0.77	\$ 0.92	\$ 0.23	\$ 0.19	22%	-70%	-75%
Book Value Per Share	\$ 27.65	\$ 27.27	\$ 27.21	\$ 26.76	2%	-2%	0%
<b>Balance Sheet</b>							
Loan HFS	23,720	19,327	7,586	11,053	-31%	-68%	-61%
Loans HTM	241,765	214,994	237,132	238,067	0%	-2%	10%
Deposits	210,882	201,380	194,280	199,096	-2%	-8%	-4%
Equity	26,458	24,210	23,965	23,681	1%	-9%	-1%
<b>Mortgage Banking</b>							
SF Loan Volume	37,168	31,035	22,329	24,911	-10%	-40%	-28%
Gain on Mtg. Loans	119	192	(222)	-	NA	-287%	-216%
Net Servicing (Exp.) Income	(1)	108	383	296	30%	-38400%	255%
Total Mortgage Revs.	118	300	161	296	-46%	36%	-46%
MSR	6,288	7,231	6,794	7,396	-8%	8%	-6%
Servicing Portfolio	439,208	474,867	463,436	473,732	-2%	6%	-2%
MSR Cap. Rate	1.43%	1.52%	1.47%	1.56%	(10)	3	(6)
					<u>Change in bps</u>		
<b>Profitability Ratios</b>							
Earning Asset (%)	6.51%	6.79%	6.84%	6.80%	4	33	5
Cost of Funds (%)	4.48%	4.42%	4.46%	4.44%	2	(2)	4
NIM (%)	2.53%	2.90%	2.86%	2.87%	(1)	33	(4)
Efficiency Ratio (%)	62.10%	56.38%	63.45%	62.16%	129	136	707
ROA (%)	0.86%	1.04%	0.25%	0.21%	4	(60)	(79)
ROE (%)	11.38%	13.48%	3.35%	2.78%	57	(802)	(1,012)
<b>Credit Quality</b>							
NPAs (%)	0.69%	1.29%	1.61%	1.63%	(2)	93	32
NCOs (%)	0.25%	0.50%	0.74%	1.00%	(25)	49	24
Loss Reserve (%)	0.64%	0.73%	0.80%	0.83%	(3)	16	7

Source: Company data, Credit Suisse estimates

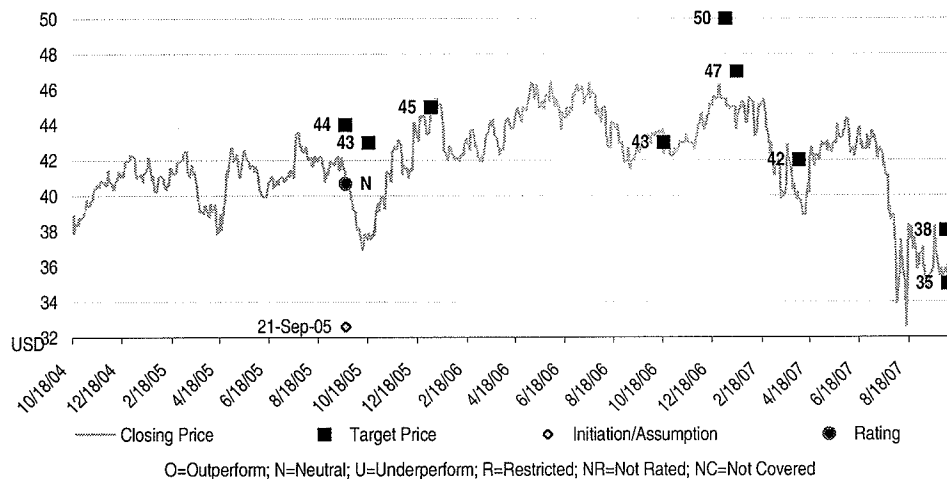
**Companies Mentioned** (Price as of 18 Oct 07)

Washington Mutual Inc. (WM, \$33.07, NEUTRAL, TP \$35.00, MARKET WEIGHT)

**Disclosure Appendix****Important Global Disclosures**

I, Moshe Orenbuch, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

**3-Year Price, Target Price and Rating Change History Chart for WM**

WM Date	Closing Price Price (US\$)	Target Price Price (US\$)	Rating	Initiation/ Assumption
9/21/05	40.67	44	NEUTRAL	X
10/20/05	37.75	43		
1/4/06	44.9	45		
10/19/06	42.35	43		
1/4/07	45.5	50		
1/18/07	44.26	47		
4/5/07	39.81	42		
10/3/07	35.89	38		
10/5/07	36.07	35		

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Restricted	2%	

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**Price Target:** (12 months) for (WM)

**Method:** Our price target of \$35 represents an absolute P/E ratio of roughly 11.5x our 2008 EPS estimate of \$3.00, in line with its historical average.

**Risks:** A rapid rise in short-term interest rates, coupled with an inverted yield curve and rising credit losses would erode the profitability at Washington Mutual, in particular its WaMu Home Loans and Card Services operating units. This would negatively impact the earnings power of Washington Mutual and cause P/E multiple contraction, impeding achievement of our \$35 target price.

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18 October 2007  
Americas/United States  
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# EXHIBIT E

## Washington Mutual Inc

Credit to worsen;  
Downgrade to Sell

Rating Change

**SELL**Equity | United States | Savings & Loans/Thriffs  
18 October 2007**Merrill Lynch**

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## Downgrade to Sell on continued credit weakness

Downgrade to Sell, as credit appears far worse than we anticipated, undermining WM's fundamentals and likely further weighing on valuation. Given material credit issues, which continue to erode, there is likely little support from a take-out, as we think few strategic buyers will be interested in stepping into a weak balance sheet. Strategic interest in WM's attractive deposit footprint and a decent yield had been the center-piece of our Neutral. Both appear at risk.

## Noisy Q3'07 finishes well-short of expectations

WM reported Q3'07 EPS of \$0.23, largely in-line with its pre-announced short-fall, due to higher credit cost and 1x charges, though a \$0.07 tax benefit suggests adj. EPS of \$0.16. Most surprising was the outlook for higher credit costs in Q4'07, \$1.2B, due to the rapidly deteriorating performance of its loan portfolio. Given the serial changes to guidance, investors are justified in assuming credit matters may be far worse than WM anticipates. Given the pace of non-performing asset growth, higher charge-offs and reserve building could persist for another year, or more. We think the results and unfavorable outlook will further embolden short-sellers and shake already nervous longs out of the stock.

## Valuation seems unattractive

WM still valued at 1.2x GAAP BV of \$28 p.s. and 1.8x tangible book value of ~\$18 p.s., well above other heavily mortgage exposed stocks. WM could witness 1x BV and 1.5x tangible, in our view, as a take-out premium is unwarranted and the dividend seems in jeopardy. Our revised '08 forecast suggests WM will barely earn its dividend, suggesting capital constraints are likely. On a valuation basis, this could prove to be a new trough, as WM has historically remained above BV. That said, WM strategy to grab higher-yields by bulking up on credit-risk looks to have positioned it poorly to weather a likely history-making downturn in housing. Timing is everything. We are late, but WM still has to work through the long-tail of credit, so downside remains, in our view.

## Estimates (Dec)

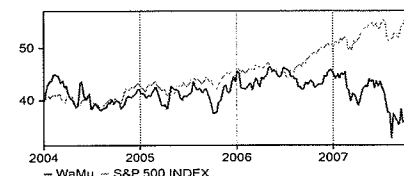
(US\$)	2005A	2006A	2007E	2008E	2009E
EPS	3.73	3.64	2.40	2.60	3.65
GAAP EPS	3.73	3.64	2.40	2.60	3.65
EPS Change (YoY)	14.8%	-2.4%	-34.1%	8.3%	40.4%
Consensus EPS (First Call: 15-oct-2007)			2.75	3.50	4.40
Dividend Rate	1.90	2.06	2.22	2.28	2.38

## Valuation (Dec)

	2005A	2006A	2007E	2008E	2009E
P/E	8.9x	9.1x	13.8x	12.7x	9.1x
GAAP P/E	8.9x	9.1x	13.8x	12.7x	9.1x
Dividend Yield	5.7%	6.2%	6.7%	6.9%	7.2%

## Stock Data

Price	US\$33.07
Investment Opinion	B-2-7 to B-3-8
Volatility Risk	MEDIUM
52-Week Range	US\$31.27-46.38
Mkt Val / Shares Out (mn)	US\$28,731 / 868.8
ML Symbol / Exchange	WM / NYS
Bloomberg / Reuters	WM US / WM.N
ROE (2007E)	8.7%
Total Dbt to Cap (Sep-2007A)	92.4%
Est. 5-Yr EPS / DPS Growth	10.0% / 8.0%



## Quarterly Earnings Estimates

	2006	2007
Q1	0.98A	0.86A
Q2	0.79A	0.92A
Q3	0.77A	0.23A
Q4	1.11A	0.35E

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Refer to important disclosures on page 6 to 7. Analyst Certification on page 5.

10662003





18 October 2007

Washington Mutual Inc

# *iQprofile*<sup>SM</sup> Washington Mutual Inc

## Income Statement Data (Dec)

(US\$ Millions)	2005A	2006A	2007E	2008E	2009E
Net Interest Income	7,886	8,122	8,207	8,824	8,965
% change	10.8%	3.0%	1.0%	7.5%	1.6%
Net Fee Income	3,200	2,907	3,284	3,662	3,877
Securities Gains / (Losses)	(82)	(9)	(57)	120	120
Total Operating Income	13,527	14,523	14,782	16,279	17,044
Operating Expenses	(7,870)	(8,728)	(8,542)	(8,803)	(9,320)
% change	4.4%	10.9%	-2.1%	3.1%	5.9%
Provisions Expense	(220)	(816)	(2,900)	(3,812)	(2,654)
% change	5.3%	270.9%	255.4%	31.4%	-30.4%
Operating Pre-Tax Income	5,437	4,979	3,340	3,665	5,070
Operating Net Income to Comm S/Hold.	3,431	3,317	2,313	2,512	3,454
GAAP Net Income	3,431	3,553	2,132	2,340	3,282

## Balance Sheet Data (Dec)

(US\$ Millions)	2005A	2006A	2007E	2008E	2009E
Total Assets	343,119	346,288	330,858	331,191	332,035
Average Interest Earning Assets	294,764	309,204	285,257	297,841	298,822
Total Gross Customer Loans	261,519	268,300	258,252	258,464	259,124
% change	5.2%	2.6%	-3.7%	0.1%	0.3%
Total Customer Deposits	193,167	213,956	215,058	215,274	215,823
% change	11.2%	10.8%	0.5%	0.1%	0.3%
Tangible Equity	18,981	18,076	14,722	15,081	16,295
Common Shareholders' Equity	27,279	27,126	23,784	24,143	25,357

## Key Metrics (Dec)

(US\$ Millions)	2005A	2006A	2007E	2008E	2009E
Net Interest Margin	2.68%	2.63%	2.88%	2.96%	3.00%
Effective Tax Rate	36.9%	33.4%	30.8%	31.5%	31.9%
Loan / Deposit Ratio	135.4%	125.4%	120.1%	120.1%	120.1%
Tangible Common Equity / Assets	5.5%	5.2%	4.4%	4.6%	4.9%
ROA	1.1%	1.0%	0.7%	0.7%	1.0%
ROE	14.6%	12.9%	8.7%	9.8%	13.3%
RoTE	18.1%	19.7%	14.5%	15.5%	20.1%
Dividend Payout Ratio	49.5%	58.9%	83.0%	78.9%	59.9%
Efficiency Ratio (Cost / Income Ratio)	57.8%	60.1%	57.6%	54.5%	55.1%

## Quality of Earnings (Dec)

(US\$ Millions)	2005A	2006A	2007E	2008E	2009E
Total Non-Interest Inc / Operating Inc	41.7%	44.1%	44.5%	45.8%	47.4%
NPLs plus Foreclosed Real Estate / Loans	0%	0%	0%	0%	0%
Loan Loss Reserves / NPLs	-0.65%	-0.61%	-0.99%	-1.20%	-1.38%
Loan Loss Reserves / Total Loans	-0.64%	-0.60%	-0.98%	-1.18%	-1.36%

## Company Description

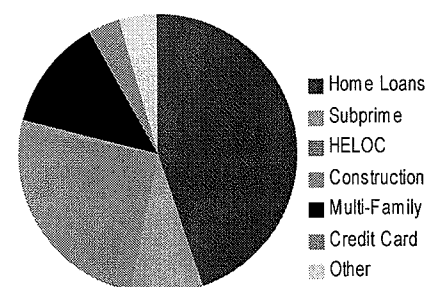
Washington Mutual Inc. (WM) is the largest US thrift-holding company and third-largest residential mortgage lender. WM is principally focused on mortgage lending/servicing, and consumer/commercial banking, and operates more than 2600 branches nationally.

Table 1: Provision guidance increased...Again

	2007-Old	2007-New	ML 2007-E
Avg. Assets	5-7%	5-7%	-7.94%
NIM	2.85-2.95%	2.85%	2.85%
Provisions	\$1.5-1.7B	\$2.7-2.9B	\$2.9B
Dep Fees	12-14%	12-14%	12.66%
Non-int Inc	\$6.9-7.1B	\$6.4-6.5B	\$6.6B
Non-int Exp	\$8.4-8.5B	\$8.5B	\$8.5B

Source: Company Reports & Merrill Lynch Research

Chart 1: Breakdown of investment portfolio



\* Subprime category includes both home loans and HELOCs.

Source: Company Reports & Merrill Lynch Estimates

## Stock Data

Average Daily Volume	9,345,381
Brokers Covered (FirstCall)	18



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**Q3'07 Key takeaways:**

- Pace of credit deterioration accelerating
- Credit outlook clouds earnings visibility
- Capital looks suspiciously low
- Poor quality balance sheet likely to keep suitors at bay

**Earnings assets up 5% sequentially (ann.) due to \$17B transfer and lower loans originated for sale:** Loans originated for sale fell to \$14B (64% of production) from \$29B (95% of production) in Q2. Available for sale balances also fell to \$7.5B from \$19.3B). Loans held for investment (ex Credit Card) increased \$23B, largely due to pre-announced \$17B transfer from AFS. Expect continued portfolioing of loans to drive growth until secondary mortgage market reopens. Average assets likely to finish below guidance range of down 5-7%.

**NIM compression due to higher cost borrowings:** NIM fell to 2.86% from 2.90% in Q2 despite average asset yields increasing 5 bps. Contraction due to larger dependence on high cost FHLB advances, offsetting a decline in lower cost deposits. Further, higher spread between 3m LIBOR and Fed funds makes borrowings relatively expensive. Expect NIM to finish '07 at the low end of 2.85-2.95% guidance.

**Reserves appear inadequate at 0.80% loans and 0.35x NPAs:** Stripping out estimated credit card related balances, reserves finish at 0.63% of loans and only 0.27x NPAs. We expect provision expense to continue to climb, possibly over WM's revised '07 guidance, and likely will continue to be a sizable headwind to earnings growth in 2008.

**GOS margin fell to -22 bps:** likely due the continued disruption in the non-conforming secondary mortgage market along with higher competition in the conforming market. Expect GOS income to remain low as WM retains the majority of its production.

**Operating expenses are low, but foreclosure expenses are increasing:** Higher foreclosures will not only increase credit costs but will add to non-interest expenses.

**De novo branch growth slows to a trickle:** WM added 10 branches while closing 33 in Q3, bring the YTD grand total up to -13 (27 new, 40 closed). WM expects to open 50 in Q4, short of stated '07 target of 100-125.

**No more repurchases.** Capital being retained to protect what is now a liquidating dividend.

**Q3 highlights credit risk; Downgrading to Sell**

WaMu reported Q3'07 EPS of \$0.23, including a \$0.07 tax benefit. Excluding the benefit, Q3 finished \$0.04 below our estimate. More importantly, Q3 results highlighted the deteriorating credit environment and WM's relatively weak loss allowance. Excluding credit card related balances, NCOs and NPAs increased to 0.55% and 2.39% of related loans while reserves finished at only 0.63%. This equates to a coverage ratio of just 0.27x NPAs (see Table 2 for trends).

**Table 2: Credit trends worsen**

	Adjusted Q3'07	Q3'07	Q2'07	Q1'07	Q4'06	Q3'06
NCO / Loans	0.60%	0.55%	0.35%	0.20%	0.16%	0.12%
NPA / Loans	2.35%	2.39%	1.96%	1.57%	1.30%	1.03%
Reserves / Loans	0.69%	0.63%	0.52%	0.51%	0.51%	0.48%
Reserves / NPAs	0.29 x	0.27 x	0.26 x	0.33 x	0.39 x	0.46 x

Excludes credit card related balances, NCOs and reserves (estimated at 5% of balances). Adjusted Q3'07 excludes \$500M of restructured loans and \$17B of recently transferred loans.

Source: Company Reports & Merrill Lynch Research

We are downgrading WM shares to sell in expectation that credit costs will continue to rise. The rapid turn in the U.S. housing market has pressured borrowers and, in our view, will lead WM to realize higher than expected losses. Visibility into the cycle trough is poor, as is illustrated by WM's serial changes to its provision guidance. However, WM's reserve will likely prove inadequate, in our view. This likely will impede EPS growth in '08 and threaten WM's dividend policy. We now estimate 2008 DPS to be \$2.28, \$0.10 below the \$2.38 implied by WaMu's current policy. However, there is some risk to our dividend assumption, in our view, as tangible capital equity runs relatively low.

We expect WM shares to trade at book value, or at a slight discount, reflecting downside risk of 10 – 20%. The usual fly-in-the-ointment is a possible take-out, which we have assigned a \$50 - \$55 value. However, we do not think a buyout is likely, given the continued lack of visibility into a worsening credit/housing market.

**Table 3: Q3'07 actual vs. estimate: Lower tax rate added \$0.07 p.s. vs. our estimate**

	Actuals 3Q:07A	% Change YY	% Change Q/Q	ML Ests 3Q:07E	Variation Dollar	%	Comparables 3Q:06A	2Q:07A
<b>Income Statement:</b>								
(\$ in Millions)								
Net interest income	\$2,014	3%	-1%	\$2,046	-\$32	-2%	\$1,947	\$2,034
Provisions	967	483%	160%	975	-8	-1%	166	372
SFR Mort. Bank	161	36%	-46%	127	34	27%	118	300
Total Non-interest income	1,379	-12%	-22%	1,361	18	1%	1,570	1,758
Total Non-interest Expense	2,191	0%	-4%	2,191	0	0%	2,184	2,278
Net income	210	-72%	-75%	183	27	15%	748	830
Diluted EPS	\$0.23	NA	-75%	\$0.20	\$ 0.03	13%	\$0.76	\$0.92
<b>Operational Data:</b>								
Avg. Earning Assets (bil)	\$283.3	-9%	1%	\$277.4	\$6	2%	\$312.8	\$279.8
WM Home Loan Orig. (bil)	22.3	-40%	-28%	30.0	-8	-26%	37.2	31.0
Net Interest Margin	2.86%	15%	-1%	2.95%	-9 bp	-3%	2.49%	2.90%
Estimated GOS (net of hedging)	-0.22%	-666%	-434%	0.40%	-259 bp	-647%	0.39%	0.65%
Tang. Equity / Tang. Assets	5.44%	-5%	-9%	5.74%	-30 bp	-5%	5.75%	6.01%
ROAA	0.26%	-69%	-75%	0.23%	3 bp	12%	0.84%	1.05%
ROAE	3.93%	-68%	-74%	3.43%	50 bp	15%	12.15%	15.40%
NCO (ann.) / Avg. loans HFI	0.71%	204%	55%	0.71%	-1 bp	-1%	0.23%	0.46%
Efficiency Ratio	63.45%	7%	1%	62.01%	145 bp	2%	62.10%	56.38%

Source: Company Reports & Merrill Lynch Estimates



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### **Credit cost rising; Reserve appears inadequate**

Credit metrics continue to worsen against WM's weak \$1.9B reserve. NCOs and NPAs finished Q3 at 0.71% and 2.30% of loans, respectively, versus only 0.86% of reserves. We expect NPAs and NCOs to continue to grow in 2008, making WM's fight to strengthen its reserve an uphill battle. Two areas of particular concern are WM's HELOC and subprime portfolios of \$3.2B and \$20B, respectively. Currently these portfolios contain \$2.9B of combined NPAs.

### **Revising estimates on higher credit costs**

We have lowered our '07 estimate to \$2.40 from \$2.80, reflecting Q3 actuals and WM's increased '07 provision guidance. Our '08 estimate has been lowered to \$2.60 from \$3.45. The revision largely reflects \$3.8B of provision expenses vs. our prior expectation of \$2.0B. We expect WM to pay \$2.28 p.s. of dividends in '08, \$0.10 below WaMu's current run rate of +\$0.01 per quarter.



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## Analyst Certification

I, Kenneth Bruce, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### *iQmethod*<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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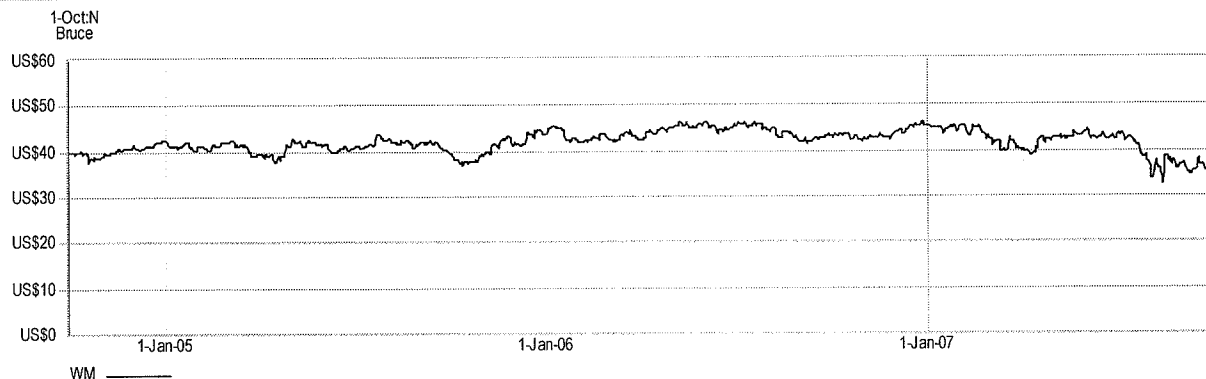


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### WM Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of September 30, 2007 or such later date as indicated.

### Investment Rating Distribution: Financial Services Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	108	38.85%	Buy	45	44.55%
Neutral	156	56.12%	Neutral	67	45.27%
Sell	14	5.04%	Sell	4	28.57%

### Investment Rating Distribution: Global Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1701	47.03%	Buy	437	29.15%
Neutral	1611	44.54%	Neutral	425	29.11%
Sell	305	8.43%	Sell	58	21.09%

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